INDEX.

LIST OF AUTHORITIES.

STATUTES.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924. No. 338.

UNITED STATES, *et al.*, *Appellants,*

v.

BUTTERWORTH JUDSON CORPORATION,
CHASE NATIONAL BANK, *et al.*, *Appellees.*

Appeal from United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE UNITED STATES.

This appeal involves the question whether the United States or certain Banks have the better title to $519,631.99 which the United States advanced to the Butterworth-Judson Corporation (hereafter called Butterworth-Judson Co.) under a restrictive written contract as to the application of the money, and which, in strict accordance therewith, the Butterworth-Judson Co. deposited in certain "Special Accounts" in the Banks.

The Banks, with *full knowledge* of the specific contract limitations upon the application of the

money, accepted the deposits with notice that they were deposited to be used for certain specific purposes only; and then they appropriated to their own use the entire deposits in payment of various unsecured debts which the Banks held against the Butterworth-Judson Co., which was *insolvent,* and *went into the hands of Receivers the next day.*

Both the DISTRICT COURT (R. 263-265) and the CIRCUIT COURT OF APPEALS (R. 312-322) held, *first,* that the Banks had the right thus to appropriate, by way of *set-off,* the deposits standing to the Butterworth-Judson's credit, in order to pay *pro tanto* the debts which the Banks held against that company, and *second,* that (*a*) the usual provisions of the United States war-time-contracts for financing munition makers and (*b*) the advance notice to the Banks that the money was deposited for certain specific purposes only, were equally ineffective to preserve to the United States either (1) its prior equitable interest in the funds it so advanced, or (2) the application of such funds to the specific purposes described in its contract of advancement.

The case turns on (1) the legal effect of a customary United States war-time-contract provision for advances to contractors, and (2) the right of Banks to accept deposits with notice of such provisions and then to disregard the terms thereof.

STATEMENT OF THE CASE.

1. *Circumstances under which the contracts were made.* In 1917-18 a great war was waging. War materials in vast quantities were urgently needed in the quickest possible time. To manufacture them in quantities large enough to meet the inconceivably great demands of modern warfare, required the building of vast munition plants at tremendous cost and the purchase of huge supplies of raw materials. No private contractors would assume such financial burdens unassisted. The Government had to finance them; and yet it could not do so, because, payments *in advance* for supplies *to be* furnished to the United States were expressly forbidden by the Act of January 31, 1823 (3 Stat. 723); *The Floyd Acceptances, 7* Wall. 666, 682).

In order to overcome that obstacle, Congress authorized the War Department

> "*to advance payments* to contractors *for supplies* * * * in amounts not exceeding 30% of the contract price of such supplies" Act October 6, 1917; 40 Stat. 383)."

Under the authority of that Act, the Government made enormous advance payments for supplies to contractors so as to furnish them with funds to erect plants in which to manufacture supplies; and in order to insure that the advances so made should be used only for the purpose of producing such supplies, it was customary to require the advance payments to be deposited in "special accounts" in bank, separate from the Contractor's other funds, and to be used only for

the specific purpose of furnishing supplies, including, where necessary, the enlargement or erection of plants for that purpose. Some instances of such advances are noted in the margin.*

2. *The "Principal Agreement" of May 9, 1918.* In the darkest hours of the Great War, a "Principal Agreement," dated May 9, 1918, was made between the United States and the Butterworth-Judson Co. (called the Contractor), which provided for the erection of a $7,000,000 picric acid plant and the manufacture thereat of 72,000,000 pounds of picric acid on the following terms (R. 38-60);

PRINCIPAL AGREEMENT DATED MAY 9, 1918.

I. The UNITED STATES agreed:

(1) To pay the entire cost of acquiring a site and erecting thereon a completely equipped picric acid plant; including the *pro rata* share of the Contractor's overhead expenses (Art. II-VI, R. 40-43);

(2) To pay 53 cts. a pound ($38,160,000) for 72,000,000 pounds of picric acid as it was delivered (R. 43, 46); with detailed provisions for (*a*) the possible furnishing by the United States of certain raw materials (to remain U. S. property), in which event there should be a corresponding abatement of the contract price, (*b*) the United States paying to the Contractor 80% of the actual cost of any raw materials bought by the Contractor (to be credited on the contract price); and (*c*) a *pro tanto* increase or decrease of

* Maxwell Motors Corporation, $5,000,000; Recording and Computing Machine Co., $2,000,000; West Penn Power Co., $2,000,000; Winslow Bros. Co., $400,000; Frost Manufacturing Co., $100,000; Minnesota Steel & Machine Co., $1,000,000; Huddleston-Marsh Co., $170,000; American Clay & Machinery Co., $2,900,000; Willys Overland Co., $2,675,000.

the 53 ct. price, as the cost of raw materials should vary from a scale fixed in the contract (R. 43-48).

(3) To recommend to the War Credits Board that it approve an *advance payment* of $1,500,000 to the Contractor "upon such *terms and conditions* and *secured* in such manner as said Board shall prescribe" (R. 50); and if the Contractor was required by the War Credits Board to pay any interest on such advance, the United States would *reimburse* the Contractor therefor as a part of the cost to be paid by the United States under the contract (R. 50); and if the $1,500,000 advance was not approved by the War Credits Board in 10 days, the Contractor might cancel the contract (R. 50).

II. The BUTTERWORTH-JUDSON Co. agreed:

(1) To design, construct and equip the plant for a profit of $1 and no more (R. 43).

(2) To manufacture and deliver 72,000,000 pounds of picric acid, to be made under the phenol process or such other process as the United States should require (R. 43, 55).*

(3) To furnish a $500,000 surety bond for the faithful performance of the contract (R. 58-59)—the premium (like the interest on the advance) to be a part of the cost *to be borne by the United States.*

III. BOTH PARTIES agreed:

(1) That the title to *"all parts* of the plant" and to *"all materials* used in the construction, maintenance or operation thereof" should vest in the United States simultaneously with *any* payment on account thereof by the United States (R. 53).

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* If any process other than the phenol process should be required, the United States was to bear all expenses of such manufacture and pay to the Contractor a fixed profit of 4 cts. per pound (R. 49).

(2) That the United States might *cancel* the contract at any time that its need for the plant or its output ceased to exist (R. 55); in which event the United States should (*a*) reimburse the Contractor for all costs and expenses, not previously reimbursed, and assume all the Contractor's outstanding obligations incurred under the contract (R. 55-56); and (*b*) pay for all picric acid wholly or partly manufactured; but if the contract should be cancelled before 18,000,000 pounds were delivered, then the United States was to pay the contractor 3 cts a pound for the undelivered portion up to 18,000,000 pounds (R. 56).

3. *The "Supplemental Agreement" of May 22, 1918.* A few days later (the approval of the War Credits Board having been apparently secured), a "Supplemental Agreement" dated May 22, 1918, was made covering the terms, conditions and security of the $1,500,000 advance payment, which was recited to be made "under the Principal Agreement" "in the interest of both parties hereto and in order to expedite the delivery of the said supplies" as follows (R. 61-66):

SUPPLEMENTAL AGREEMENT DATED MAY 22, 1918.

I. The UNITED STATES (called the Government) agreed:

(1) To advance to the Contractor $1,500,000 "on the terms and security" therein mentioned (R. 62);

(2) Not to negotiate nor demand payment of the Contractor's $1,500,000 note given as security for such advance, so long as the contractor was not in default; and to return to the Contractor the note and surety bond upon the Contractor's complete performance of its obligations under the Supplemental Agreement (R. 64-65).

(3) To permit the Contractor to repay to the Government, in cash, at any time, the entire unpaid balance of the advance and interest.

II. The BUTTERWORTH-JUDSON Co. (called the Contractor) agreed:

(1) "As *collateral security* for the recoupment or return of the above mentioned advance [$1,500,000] and any interest due", the Butterworth-Judson Co. would (*a*) execute its demand note for $1,500,000 bearing 6% interest, payable to the Secretary of War (R. 64); and (*b*) furnish a $750,000 surety bond for the faithful performance of its obligations under such Supplemental Agreement (R. 64), *i. e.* the return of the $1,500,000 in cash or its discharge by furnishing to the Government picric acid at the rate specified in the Supplemental Agreement (R. 62).*

(2) To account to the Government for the $1,500,000 advance, with interest thereon, (at the rate of 7% for the 9 days in May, and thereafter at such rate as the War Credits Board should determine from month to month), by applying the advance, with interest, to the payment of vouchers presented by the Contractor to the Government covering deliveries of picric acid under the Principal Agreement, as follows (R. 62):

(*a*) In paying the first vouchers due to the Contractor for picric acid deliveries, until the Government shall have recouped (of the advance) $500,000, *i. e.* about 943,396 pounds or (say) the first 5 days run of the plant;

* In the event of the Contractor's default with respect to the payment of the $1,500,000, the Government was given the power to sell, at public or private sale, the Contractor's $1,500,000 note and to apply the proceeds to the payment of the advance and the Government might become the purchaser of the note freed from *every trust* and obligation (R. 64).

(*b*) Then the Government should pay for the picric acid received until 57,000,000 pounds shall have been delivered (about the next 9 months' run of the plant).

Thereafter, the remaining $1,000,000 of the advance (with accrued interest) should be discharged by applying it at the rate of 10 cents for each pound of picric acid delivered; *i. e.* until about 11,000,000 pounds were delivered—or the next 2 months' run.*

(3) If the Government should fail to recoup its $1,500,000 in the above manner (even though it was because the Government cancelled the contract), then the Contractor should return to the Government any balance of the $1,500,000 (and interest) remaining unpaid, after deducting (1) the recoupments made, and (2) "all liquidated accounts that may be due and owing under the Principal Agreement from the Government to the Contractor, *i. e.*, any unpaid costs, expenses, disbursements, interest on the advance, and the 3 cents per pound liquidated damages on undelivered picric acid up to 18,000,000 lbs. (R. 63, Cf. R. 56).

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* The schedule for the liquidation of the $1,500,000 and interest would work out about as follows, based on the contract estimate of the time of completion and capacity.

Time Consumed	Picric Acid Deliveries	Price to be Credited	Amount Liquidated
5 days	943,396 lbs.	.53	$500,000
280 "	56,056,604 "	no liquidation	
50 "	10,000,000 "	.10	1,000,000
5 "	1,000,000 "	(est) .10	100,000 (Int.)
340 "	68,000,000 "		$1,600,000

In this way it was contemplated that the entire $1,500,000 advance would be repaid before the 72,000,000 lbs. contract was completed.

The interest (estimated at $100,000), while required by the War Credits Board to be paid by the Contractor by deliveries of picric acid, was in turn, however, to be *reimbursed* to it by the United States as a part of costs (Principal Agreement, Art. XVII; R. 50).

(4) To deposit the $1,500,000 in a "Special Account," to be disbursed *only* for certain specific purposes. As the controversy turns on this clause, it will be given in full (R. 64-65).

"Article VI

"The Contractor *shall deposit* the money advanced hereunder *in special accounts* in banks, *separate from its other funds,* and shall draw on said accounts *only* in payment of expenditures made and obligations incurred in designing, constructing and equipping the plant specified in the Principal Agreement, and for other equipment and material, labor and overhead expense, required in the *direct performance* of the Principal Agreement, unless otherwise authorized in writing by the War Credits Board.

The contracting officer may require that the contractor shall deposit in said accounts funds paid by the Government to the contractor reimbursing the contractor for expenditures made from this advance in designing, constructing and equipping the plant, as provided in Article VI of said contract between the parties hereto, dated May 9, 1918.

The contractor *shall secure* from the banks with which such accounts are placed, *such interest* as is *usually allowed* for similar accounts and shall *credit or pay said interest to the Government* in such manner as the contracting officer may direct."

4. *The Surety Company bonds.* On the same day, May 22, 1918, the Butterworth-Judson Co. furnished (but at the *Government's cost* as allowed by the contract, R. 59) two separate surety company bonds, as follows:

(*a*) One for $500,000 conditioned for the faithful performance of the Principal Agree-

ment of May 9, 1918 only, *i. e.*, erection of the plant and the manufacture of picric acid thereat (R. 67-69).

(*b*) One for $750,000 conditioned for the performance of the Supplemental Agreement of May 22, 1918, *i. e.*, the proper application of the $1,500,000 advance and its repayment or the return of the unexpended balance [$1,059,613.99] in the event of the cancellation of the contract before such repayment could be effected by deliveries of acid (R. 73-75). Under this bond, the Surety Companies are liable to the United States, if the Banks succeed in holding the $519,613.99 which the Butterworth-Judson Co. is under bond to return to the United States.

5. *The $1,500,000 advance.* The Government advanced the $1,500,000 to the Butterworth-Judson Co. which simultaneously executed its demand note therefor at 6% interest payable to the Secretary of War, which is still held by the Government and no demand for its payment has been made (R. 25, 26).

The Butterworth-Judson Co. promptly deposited the $1,500,000 advance in the several Banks, appellees herein, in "Special Accounts" separate from its other funds (R. 26).

The Banks knew that the deposits were made with the $1,500,000 furnished by the Government for the specific purpose of being used solely in the building of the plant and the manufacture of picric acid thereat; and with such knowledge *accepted* the deposits in "Special Accounts" (R. 30).

6. *The construction of the plant.* The Butterworth-Judson Co. began the erection of the plant and continued work at a cost to the Government of over $7,249,035.16 with the plant only 50%

completed, when on December 7, 1918. the Armistice having been signed, the Government cancelled the Principal Agreement under the reserved power to terminate it, if the need for the plant and picric acid ceased to exist (R. 27).

CLAIMS OF THE BANKS.

7. *Chase National Bank.* On May 27, 1918, the Butterworth-Judson Co. deposited its entire $1,500,000 advance in the Chase National Bank in a "Special Account", which as the result of checks drawn thereon and Governmental reimbursements thereto, was, after nearly four years, to wit, on April 21, 1922. $232,844.80 (R. 31, 133).

With full knowledge of the nature of that "Special Account", of the restrictive terms of its deposit, and of the Government's rights therein as set out in Art. VI of the Supplemental Agreement (R. 64), the Chase National Bank, long *after* the cancellation of the contract, loaned $600,000 to the Butterworth-Judson Co. as follows (R. 30, 133, 134):

1920	
August 30.....	$250,000
Sept. 7.....	350,000
Total loans.....	$600,000

Nearly two years thereafter, to-wit, on April 21, 1922, *after* the Butterworth-Judson Co. was in financial difficulties. and *on the same day* that it consented to the appointment of a Receiver (R. 10), the Chase National Bank appropriated to itself the $232,844.80 standing to the credit of "Butterworth-Judson Co. *Special Account*" and applied it towards the payment of its own $600,000

claim against that company, so as to reduce it from $600,000 to $367,155.20 (R. 31, 134).

8. *American Exchange National Bank.* In June, 1918, the Butterworth-Judson Co. opened a similar "Special Account" with the American Exchange Bank, the balance in which on April 21, 1922, was $115,501.60 (R. 31, 172).

With similar full knowledge as to the facts, the American Exchange Bank long *after* the cancellation of the contract, loaned $300,000 to the Butterworth-Judson Co. as follows (R. 30, 171):

1921	
January 10	$100,000
March 28	200,000
Total loans	$300,000

Likewise, on the same day (April 21, 1922) that the Butterworth-Judson Co. consented to a Receivership, the American Exchange Bank appropriated the $115,501.60 deposit in the "Special Account" toward the payment of its own $300,000 claim (R. 31, 172).

9. *New York Trust Co.* The "Special Account" was opened with the New York Trust Co. (or rather with a bank subsequently consolidated with it) on June 19, 1918, and the balance therein on April 21, 1922, was $70,225.87 (R. 31, 153).

With full knowledge of the facts, the New York Trust Co., long after the contract cancellation, loaned $100,000 to the Butterworth-Judson Co. (R. 153). On the same day as the other Banks acted (April 21, 1922), the New York Trust Co. appropriated the $70,225.87 balance towards the payment of its $100,000 note (R. 31, 153).

10. *National Newark & Essex Banking Co.* On June 4, 1918, the Butterworth-Judson Co. deposited $250,000 of the Government advance in a "Special Account" (R. 31, 195, 197); and on the same day the Newark & Essex Bank loaned it $250,000, with full knowledge of the restrictive character of the "Special Account" deposit (R. 30, 195, 198, 208).

Simultaneously with the other Banks, on April 21, 1922, the Newark & Essex Bank appropriated the then $101,166.10 balance in the "Special Account" toward the payment of its $250,000 debt (R. 31, 198).

11. *The actions of the parties under the contracts.* During the construction period, the Butterworth-Judson Co., in strict accordance with the terms of the Supplemental Agreement (Art. VI, R. 64-65), from time to time, drew checks on the various $1,500,000 "Special Accounts" in payment of the expense of erecting and maintaining the plant (Art. VI, IX, R. 42, 45); and the Government reimbursed it therefor, which reimbursed sums were in turn re-deposited in the "Special Accounts" as required by Art. VI (R. 65) so as to keep the $1,500,000 advance in the "Special Accounts" as nearly intact as possible (R. 26). The reimbursements aggregated about $8,500,000 for the plant (R. 27). After the Government cancelled the contract, it assumed and paid all the outstanding obligations incurred by the Butterworth-Judson Co. in connection with the plant (R. 27, 28).

The Butterworth-Judson Co. refunded $348,550 to the Government, which then left the account (excluding interest which the Butterworth-

Judson Co. were exonerated from paying, Art. XVII, R. 50) as follows (R. 33):

Advance Payment	$1,500,000
Refunded to U. S. by Contractor (R. 28)	348,550
	$1,151,450
Retained by the Contractor as alleged "liquidated damages" on Cancellation of contract; 18,000,000 lbs. at 3¢ a pound (Art. XXVI, R. 56)..	540,000
Balance concededly due to U. S.....	$611,450

It will be especially noted (1) that all the Banks *accepted* the deposits with *full knowledge* of the contractual restrictive limitations on the "Special Accounts", the interest of the Government therein and the specific purposes for which the special deposits were made and intended to be used; (2) that all the Banks (except the Newark & Essex Bank) made their loans to the Butterworth-Judson Co. long *after* the Government's cancellation of the contract, and when the "Special Accounts" had become static as it were, with the rights of the Government and the Contractor therein fixed; and (3) that, *by concert of action between the Banks,* they, on the *very day* that the Butterworth-Judson Co. verified its answer *consenting to a Receivership,* seized the "Special Account" deposits and applied them in payment of their own respective claims against the company.

Does the Banker's right of "set-off" authorize such conduct? That is the question here involved.

12. *History of the Litigation.* On January 9, 1923, the United States filed its bill against the Butterworth-Judson Co., its Receivers, the Banks, and the Surety Companies on the $750,000 bond,

alleging the above facts, and asking (*a*) an accounting with the Butterworth-Judson Co. (*b*) a recovery from the Banks of the "Special Accounts" so seized, and (*c*) a judgment over against the Surety Companies upon their bonds for any balance finally found due by the Butterworth-Judson Co. to the Government (R. 3-36).

The Government's total claim against the Butterworth-Judson Co. on account of the advance payment is (*after* crediting the $348,550 refunded) about ~~$800,000~~ $1,150,000

The Receivers and Surety Companies answered and also filed Counter-claims against the Banks, seeking to have the "Special Account" deposits paid over to the United States (R. 101, 128).

The Banks answered to the merits, and also moved to dismiss the bill and the Counter-claims for want of equity (R. 241-262).

The District Court (A. N. Hand, J.) dismissed both the bill and the Counterclaims upon the sole ground that, as the Butterworth-Judson Co. was *nominally* to pay interest to the Government on the $1,500,000 advance (even though such interest was to be reimbursed to it by the Government), this made the relation between the company and the Government merely that of an ordinary debtor and creditor, and that the Banks were entitled to "set-off" the "Special Accounts" deposits against what the company owed them, saying (R. 265):

> "There is no doubt that special deposits *might* have been made sufficient to prevent a set-off by any banks having notice of the nature of the deposits, but under the agreement involved in this case the advances were *not*, in my opinion, special deposits of that limited character, and *the relation was one of*

debtor and creditor. The provision for interest, even though the amount of interest was allowed to the contractor in the final adjustments as part of the cost or expense incurred, *made the relation,* in my opinion, one of *debtor and creditor.*

The agreement to account for the fund and to expend it in a certain way was no more than a *contractual provision* between the parties requiring the contractor to promise to use the advance only for Government work, and did not create either a trust or a special deposit with the fiduciary relation between the parties which prevented a set-off by the banks. I have been referred to no case exactly like the present one and shall, therefore, not cite authorities, but I think the ordinary rule that the *charge of interest* upon a transfer of money makes the relation one of debtor and creditor, *determines the question.*"

OPINION OF THE CIRCUIT COURT OF APPEALS.

The Circuit Court of Appeals affirmed the decree (R. 312; *U. S.* v. *Butterworth-Judson Corp.,* 297 Fed. 971).

The Court of Appeals held, for various reasons assigned, that the relationship between the Butterworth-Judson Co. and the United States was simply one of debtor and creditor (R. 317); that the $1,500,000 was in no sense a trust fund capable of being followed into the hands of the Banks, *because* there was no designated beneficiary nor any designated trustee who was not a beneficiary (R. 217); that it was not a "revolving fund" of the United States but a loan (R. 317, 318); that it was not a "Special Deposit" in the sense that

the Banks must return the specific thing left with them (R. 319); that the case was controlled by their own decision *In Re Interborough Consolidated Corp.,* 288 Fed. 334 (R. 319); and said (R. 319):

> "We see no justification for applying to the funds on deposit any doctrine of trusts or equitable lien or equitable assignment."

The Court of Appeals gave no consideration whatever to the point that when a bank *accepts* a deposit with notice from the depositor that the money is deposited for the express purpose of being used for certain specific purposes, the bank thereby accepts the deposit *subject to such terms,* which are manifestly inconsistent with the theory of a general deposit against which the bank might lend money, and that the bank cannot thereafter assert its right of set-off against such a deposit.

ASSIGNMENT OF ERRORS.

The assignment of errors raises the question of the sufficiency of the bill (R. 272).

SUMMARY OF POINTS DISCUSSED.

1. The $1,500,000 advance payment to Butterworth-Judson Co. was subject to an equitable lien in favor of the United States and it was impressed with the character of a trust fund (pp. 19-39, *infra*).

2. The Banks accepted the deposit with full knowledge that the Butterworth-Judson Co. made the deposit for the sole purpose of having the money applied by its own checks to certain specific purposes.

Therefore, the Banks cannot assert the right of set-off against the deposit (pp. 40-67, *infra*).

3. Analysis of the opinion of the Circuit Court of Appeals and a response to certain contentions of the Banks (pp. 68-78, *infra*).

FIRST POINT.

The $1,500,000 advance payment to Butterworth-Judson Co. was subject to an equitable lien in favor of the United States and it was impressed with the character of a trust fund.

The effect of the two contracts is briefly summarized in the margin*.

Under the enormous pressure for American aid to the Allies, during the great German drive of the Spring of 1918, when the fate of the war was

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* 1. The Government agreed to *pay* for a site to be selected by the Contractor, together with *all expenses* incident to its acquisition (R. 40).

2. The Contractor agreed to build thereon, *at the Government's expense,* a complete plant, *without any profit* or even compensation for its own services (R. 43).

3. The Contractor agreed to manufacture and deliver 72,000,000 pounds of picric acid at 53 cents per pound.

4. The Contractor had to make "all necessary expenditures in respect of the costs and expenses" incurred in building the plant, and to submit "satisfactory evidence" of the expenditure; and, thereupon, the Government "shall promptly *reimburse* the Contractor therefor" (Art. VI, R. 43).

Furthermore, in the manufacture of the picric acid itself, the Contractor had to pay for its material, etc., before it could get the 80% reimbursement (R. 44).

5. Therefore, in order to finance the Contractor's needs, the Government agreed to advance to it $1,500,000 upon these conditions:

(*a*) The contractor to give its demand note for $1,500,000 with interest; and to give a $750,000 surety bond for the proper application of the money.

(*b*) The Contractor, nominally, to pay interest on that $1,500,000, but the Government to reimburse any sums paid as interest, by including such sums as cost to be repaid to the Contractor.

(*c*) The Contractor to deposit the $1,500,000 in Banks, in "Special Accounts", separate from its

trembling in the balance, the United States sought by these and many similar contracts, to secure the building of munition plants and the production of munitions thereat, in vast quantities, in the quickest possible time. It was willing to furnish the necessary capital for the construction of the plants and to assist the contractor in financing the operation thereof; but it intended to insure that the Government monies thus advanced should be devoted to those purposes alone and not be diverted to other aims of the Contractor, nor be subject to seizure by the Contractor's general creditors.

By the contracts in this case, the Government made an advance payment of $1,500,000 to the Contractor, who agreed to deposit it in "special accounts" in banks, separate from its other funds,

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other funds and to draw on the $1,500,000 only (1) to pay for the erection of the plant, and (2) to pay for labor, material and equipment used in manufacturing the picric acid.

(*d*) The Contractor to redeposit in such "Special Accounts" all sums it received from the Government in reimbursement of the Contractor's outlays in building the plant.

(*e*) *The Contractor to pay to the Government all interest* allowed by the Banks on the "Special Accounts".

(*f*) The Contractor to account for the $1,500,000 to the Government (by furnishing picric acid) as follows: (1) $500,000 by *furnishing free* the first 943,396 lbs. manufactured, (2) no further payments until after 57,000,000 lbs. were delivered, and (3) then the $1,000,000 balance, with interest, to be paid by a credit of 10 cents a pound on about the next 11,000,000 lbs. of future deliveries of picric acid.

6. If the Government did not get its $1,500,000 recouped in the manner above outlined, the Contractor was to return to the Government any *unexpended* balance in the "Special Accounts" after deducting any sums the Government owed the Contractor for advances, interest, or liquidated damages if the contract was cancelled.

to pay to the Government all interest allowed by the banks on such deposits, and to draw upon such accounts only in payment of expenditures required in the direct performance of the contract, to-wit: the erection of the plant and the production of munitions thereat* (R. 64, 65).

The Butterworth-Judson Co. scrupulously fulfilled all the contract requirements.

We submit:

I. The contracts created in favor of the United States an equitable lien upon the fund, or impressed it with the character of a trust fund.

The legal effect of the contracts cannot be determined by any one provision, but the totality of them must be regarded, and their relations and purposes (*Duesenberg Motors Corp.* v. *U. S.*, 260 U. S. 115, 122).

The contracts should be construed as adopting whatever method or form, consistent with the facts and with the rights reserved, is most fitted to reach the result seemingly desired (*Sexton* v. *Kessler,* 225 U. S. 90, 96; *Barnes* v. *Alexander,* 232 U. S. 117, 120).

1. While the title to the $1,500,000 fund, and the replenishments thereof, passed to the Butterworth-Judson Co., the United States and Butterworth-Judson Co. intended, and by contract attempted, to insure (1) that the fund should be set apart in a "Special Account", separate from all other moneys, and devoted solely to the erection of the plant and the manufacture of munitions

* The Government took a $750,000 Surety Company bond as additional security that the $1,500,000 would be used only as stipulated in the contract (R. 64).

thereat, and (2) that to the extent *not* so devoted, it should be *returned* to the United States.

The United States did not part with,—nor did the Butterworth-Judson Co. acquire,—complete and absolute control over the fund, as the following facts, inconsistent with unrestrained ownership, demonstrate:

(*a*) The money had to be kept in "*special accounts* in banks, separate from its other funds" (R. 64).

(*b*) It could *not* be used for the company's *general* purposes; but it could be drawn from bank *only* to pay for erecting the plant or making Government munitions thereat (R. 65).

(*c*) The Butterworth-Judson Co. was bound to pay to the United States *all interest* which the Banks allowed on the deposit (R. 65).

(*d*) The Butterworth-Judson Co. reserved the right at any time to "repay" to the Government, in cash, the entire balance of the fund (R. 63). This shows it was not a *payment* in the ordinary sense.

(*e*) The Butterworth-Judson Co. was compelled to *return* any balance to the Government, if the supplies were not furnished.

(*f*) The Butterworth-Judson Co. gave a note as evidence of the advance, and also furnished a $750,000 surety bond, as security for the faithful performance of its obligations (*a*), (*b*), (*c*) and (*e*), *supra*.

(*g*) If the Butterworth-Judson Co. failed to keep the money in a "special account" separate from its other funds, or if it used it for any other purpose than for the plant and munitions, the Government could sell the note and buy it in "free of all *trusts* and claims

whatsoever" (R. 64) which indicates the qualified nature of the advance payment.

(*h*) Under the authority given by the Act of October 6, 1917 (40 Stat. 383), for the Secretary of War to "prescribe [and to] require adequate security for the protection of the Government for the [advance] payments", he created a War Credits Board to administer such "advance payments" and prescribed the "rules and restrictions" under which they could be made.

One of the directions to the Government's contracting officers was that, in order that "the Government shall be adequately protected", the advance payments should be made (R. 320-322)

> "under such conditions and restrictions that the funds advanced are definitely procured to be held *in trust* until paid out under the contract, for property to which the Government holds or *automatically acquires title*, or in meeting expenses *incurred in the direct performance* of the contract for supplies."

The contracts here, by appropriate terms, limited the advance payments in precisely that very manner and almost in that verbatim language.*

Both parties intended to safeguard, and thought they had safeguarded absolutely, the application of the $1,500,000 solely to work *under* the contract.

Will this Court say that the contract legally *failed* to accomplish that end?

2. The lower Courts both held that it was a loan, pure and simple; that the *only* relation was that

*Cf. Art. XXII (R. 53) vesting title automatically *in* the U. S. to "all *parts*" of plant, and "*all materials*" on *any* payment therefor; Art. VI (R. 64, 65), creating a separate fund to be used only for building the plant or in direct performance of the contract for supplies.

of debtor [Butterworth-Judson Co.] and creditor [United States]; and that no fiduciary or equitable element was involved (R. 265, 317, 319). That was clearly erroneous.

Certainly such was not the intention of the parties, for if it had been, then why all the special provisions, limiting the Contractor's power over his own money? If it be responded that such provisions were to secure the ultimate return of the fund itself to the United States, then that, by very definition, constituted an equitable lien upon, or equitable assignment back of, the fund to the Government.

A few illustrations will be useful.

(A) Suppose a tenant leased a building from a landlord for 3 years at $10,000 a year rent; and the lease required the tenant to pay the 3 years rent [$30,000] in advance, and the landlord to deposit such advance payment of rent in a "special account" in bank, which was to be applied solely and exclusively to the fitting up of the leased premises for the specific needs of the tenant. Is it possible that under such circumstances, the bank with knowledge of those facts could accept the deposit and *immediately* upon deposit of the $30,000 in the "special account", seize it and offset it against a prior debt it had against the landlord?

Or, again, is it possible that, shortly after the deposit was made, the landlord's creditors could attach the $30,000 "special account" as a general asset of the landlord? Or, if the landlord became bankrupt, could the trustee in bankruptcy seize the deposit for distribution among the creditors generally without any regard to the prior lien or claim thereon of the tenant who had made the advance payment under such restrictive conditions?

(B) Suppose that during the war emergency, under the authority of the Federal Control and Transportation Acts of March 21, 1918, February 28 and June 5, 1920 (40 Stat. 451, 468, 946), the Government had advanced to a railroad $2,000,000 with which to buy "equipment" or make "additions and betterments" or build a side track to a powder plant, in order "properly to meet the transportation needs of the public" or because "desirable for war purposes". And suppose, as "security to be given for repayment" the Government had stipulated that the advance should be deposited in a "special account" in bank, to be checked out only for those purposes. Can it be that a great Governmental plan in aid of objects entrusted to it by the Constitution, could be frustrated by some general creditor, or past-due coupon holder, or stockholder whose declared dividend had not been paid, attaching such fund, leaving the Government remediless and the railroad without the facilities desired?

A bank's right of set-off is even weaker than the right of an attaching bondholder (who has a mortgage on the Company's property, franchise, rents and profits); and yet would anyone contend that the bond-holders and creditors, knowing the arrangement by which the money was advanced by the Government, could seize it to pay their own claims?

Or could the bank, *eo instanti* the deposit was received with full knowledge of such terms, appropriate the $2,000,000 as a set-off against a floating debt it held against the railroad?

(C) If the Banks have, as the lower Courts held, the unrestrained right of "set-off", they

growing out of the law merchant and is one that gives the Bank, in effect, a preference over other creditors. It must be clearly shown before it can be maintained. If the right of "set-off" is denied to the Banks, they are not really losing anything, but are being merely put on a parity with other creditors.

4. Parties may, by contract, create an *equitable lien* on property sufficiently identified. An equitable lien is merely a right to secure the performance of some outstanding obligation, by means of a proceeding directed against *the thing* which is the subject of the lien. It is not, strictly speaking, a trust, and the Butterworth-Judson Co. as the owner of the fund, was not, strictly speaking, a trustee for the United States—although many writers would so treat it (3 Pomeroy's Equity Jurisprudence (4th Ed.) § 1234).

For example, some writers would say that when the deposit was made in the Banks, the Butterworth-Judson Co. had a *chose in action* against the Banks for the amount of the deposit, which could be discharged by the Banks paying the deposit to Butterworth-Judson Co. or to the holders of checks duly drawn thereon; that the Butterworth-Judson Co. was, as between itself and the Government, a *Trustee* of such *chose in action,* for the United States as the beneficiary thereof; and that the Banks, having knowledge of such trust relationship, cannot exercise the right of set-off (*Beaver Board Cos.* v. *Imbrie & Co.,* 287 F. R. 158, 162).

5. The Butterworth-Judson Co. was under obligation to expend this money in a specific manner,

and no other. To secure the performance of that obligation, the fund was sequestered from all its other funds. It was denied the interest earned thereon. It could only use it for certain limited purposes under that particular contract. The form, or particular nature of the agreement which shall create an equitable lien, is not very important, for equity looks at the *final intent and purpose* rather than at the form, which is immaterial if the intent appears to make any identified fund a security for the fulfillment of an obligation (3 Pom. Eq. Jurisprudence, 4th Ed. §§ 1235, 1237; *Hauselt* v. *Harrison,* 105 U. S. 401, 406-408; *Walker* v. *Brown,* 165 U. S. 654, 664-5; *Ingersoll* v. *Coram,* 211 U. S. 335, 368; *Barnes* v. *Alexander,* 232 U. S. 117, 121.)).

It must be remembered, as held in *Knatchbull* v. *Hallett,* 13 Ch. D. 696, and adopted in *National Bank* v. *Insurance Co.,* 104 U. S. 54, 68, that the Rules of Equity, are, from time to time, altered, improved, refined and invented for the purpose of better securing the administration of justice; that equity rules are progressive, and that one must look to the more modern rather than to the ancient cases—although the doctrine of equitable liens as applicable here is very ancient, as two old English cases, presently to be noticed, show.

The growth of the doctrine of this Court with respect to equitable liens is very marked by contrasting *Christmas* v. *Russell,* 14 Wall. 69 (1870), and *Trist* v. *Child,* 21 Wall. 441 (1874), with the progressive extension in the later cases of *Fourth Street Bank* v. *Yardley,* 165 U. S. 634; *Walker* v. *Brown, Id.* 654; *Ingersoll* v. *Coram,* 211 U. S. 335, 368; *Barnes* v. *Alexander,* 232 U. S. 117, 120

(practically overruling *Trist* v. *Child*), and *Valdes* v. *Larrinaga*, 233 U. S. 705.

In 3 Story's Equity Jurisprudence (14th Ed.) § 1637, it is said:

> "Indeed there is generally *no difficulty* in equity *in establishing a lien* not only on real estate but on personal property, or on money in the hands of a third person, wherever *that is a matter of agreement, at least against the party himself*, and third persons who are volunteers or have notice. For it is a general principle in equity that as against the party himself, and any claiming under him voluntarily or with notice, such an agreement raises a *trust*."

In 1 Pomeroy's Eq. Jurisprudence, 4th Ed. § 165, it is said:

> "An equitable lien is not an estate or property in the thing itself, nor a right to recover the thing,—that is, a right which may be the basis of a possessory action; it is neither a *jus ad rem* nor a *jus in re*. It is simply a right of a special nature *over* the thing, which constitutes a charge or encumbrance upon the thing, so that the very thing itself may be proceeded against in an equitable action, and either sold or sequestered under a judicial decree, and its proceeds in one case, or its rents and profits in the other, applied upon the demand of the party in whose favor the lien exists. It is the very essence of this conception, that while the lien continues, *the possession* of the thing *remains with the debtor* or person who holds the proprietary interest subject to the encumbrance."

So here. The Butterworth-Judson Co. held possession of the fund, to-wit: a chose in action against the Banks, but the lien in favor of the

United States continued, although the possession of the fund had been surrendered by the United States and the title thereto had passed to the Butterworth-Judson Co.

Again, § 166:

> "When equity has jurisdiction to enforce rights and obligations growing out of an executory contract, this equitable theory of remedies cannot be carried out, unless the notion is admitted that the *contract creates some right or interest in or over specific property, which the decree of the Court can lay hold of,* and by means of which the equitable relief can be made efficient. The doctrine of *equitable liens supplies this necessary element,* and it was introduced for the *sole purpose* of furnishing a ground for the *specific remedies* which equity confers, operating upon *particular identified property,* instead of the general pecuniary recoveries granted by courts of law. It follows, therefore, that in a large class of executory contracts, express or implied, which the law regards as creating no property right nor interest analogous to property, but only a mere *personal right and obligation,* equity recognizes, *in addition to the obligation,* a peculiar right *over* the thing with which the contract deals, which it calls a 'Lien', and which, though not property, is analogous to property, and by means of which the plaintiff is enabled to follow the identical thing, and to enforce the defendant's obligation by a remedy which operates directly upon that thing."

In *Legard* v. *Hodges,* 1 Ves. Jr., 478 (quoted with approval in *Ketchum* v. *St. Louis,* 101 U. S. 306, 316), in order to raise a certain sum, a life tenant agreed to pay over one-third of the net

profits of his estate to certain Trustees. Subsequently he *conveyed* his life estate to other Trustees having notice of his former agreement. The second Trustees claimed that there was no lien upon the land by the first agreement, but a mere *personal covenant*. The Lord Chancellor (THURLOW) held that the contract was not a mere personal covenant with a remedy at law, but that

> "* * * whatsoever is the agreement concerning any subject real or personal, though in form and construction purely personal and suable only at law, yet in this Court it binds the conscience * * *, this maxim which I take to be universal that *wherever persons agree concerning any particular subject,* that in a Court of Equity as against the party himself, and any claiming under him voluntarily or with notice, *raises a trust.* These persons have so claimed; and therefore this is a pure TRUST estate, and they must be declared trustees for one-third of the clear annual profits, and must account from the time of taking possession having all just allowances."

This case was affirmed on rehearing by Lord Chancellor LOUGHBOROUGH.

In *Dodsley* v. *Varley,* 12 Ad. & E. 632, a seller delivered possession of certain wool to the purchaser, who placed it in a warehouse belonging to a third party, where it was weighed and packed in the purchaser's sacks. The course of dealing was for the wool to remain in the warehouse until paid for. It was neither removed nor paid for. In a suit by the purchaser it was held that although there had been a delivery and acception of the goods, the plaintiff retained a *special interest* in

them (not properly a lien) in respect of the arrangement not to remove the wool until paid for.

Lord Chief Justice DENMAN, in sustaining a verdict for the plaintiff, held that everything was complete except the payment of the price, and said:

> "We think that, upon this evidence, the place to which the wools were removed must be considered as the defendant's warehouse, and that he was in actual possession of it there as soon as it was weighed and packed; that it was thenceforward at his risk, and, if burnt, must have been paid for by him. Consistently with this, however, the plaintiff had, not what is commonly called a lien, *determinable on the loss of possession,* but a *special interest,* sometimes, but *improperly,* called a lien, growing out of his original ownership, independent of the actual possession, and *consistent with the property being in the defendant.* This he retained in respect of the term agreed on, that the goods should not be removed to their ultimate place of destination before payment. But this lien is consistent, as we have stated, with the *possession* having passed to the buyer, so that there may have been a delivery to, and actual receipt by, him."

These two English cases establish the proposition that by contract between two persons, one can retain a *specific interest* in, or lien upon, the subject matter of the contract, even though title and possession have both been parted with, as against third persons having notice of the arrangement.

This Court has held exactly the same thing.

In *Ingersoll* v. *Coram,* 211 U. S. 335, Ingersoll wrote Coram and Root inquiring what his fee would be and how it would be secured. They wrote him that he would get a $100,000 fee in

case their clients got their share of the estate, but that there would be no personal obligation against Coram except to pay the fee out of the funds secured from the estate by certain heirs. The Court held that Ingersoll thereby acquired a lien upon the shares of such heirs, saying:

> "It is evident, therefore, that Ingersoll asked for security in a definite and written form. We do not think it can be said that he sought *only* a promise to pay. That followed from his employment, and besides Coram stipulated against personal liability, but did obligate himself to pay 'out of the funds secured from the estate'. And this is the test of the agreement. It is the exception that establishes that as to Root there was a personal *and property* obligation; as to Coram, a *property* obligation."

In *Barnes* v. *Alexander,* 232 U. S. 117, Barnes had a contingent fee of 25%. He stated to a fellow lawyer, Alexander:

> "If you will attend to this case I will give you one-third of the fee which I have coming to me on the contingent fee from Shattuck, Hanninger and Marks."

This was a *personal promise* and Barnes contended that it gave to Alexander no specific lien against the fund itself. This Court held that Alexander had an equitable lien, saying:

> "He [Barnes] promised only that if, when and as soon as, he should receive an identified fund, one-third of it should go to the appellees. But he promised that. At the latest, the moment the fund was received the contract attached to it as if made at that moment. * * *

> The obligation of Barnes was as definitely limited to payment out of the fund as if the limitation had been stated in words, and therefore creates a lien upon the principle not only of *Wylie* v. *Coxe, supra,* but of *Ingersoll* v. *Coram,* 211 U. S. 335, 365-368, which cites it and later cases. See further to the same point, *Burn* v. *Carvalho,* 4 My. & Cr. 690, 702, 703; *Rodick* v. *Gandell,* 1 DeG., M. & G. 763, 777, 778; *Harwood* v. *LaGrange,* 137 N. Y. 538, 540. It is suggested that there is an American doctrine opposed to that which is established in England. We know of no such opposition. There is or ought to be but one rule, that suggested by plain good sense. * * * The latter firm filed no claim against the estate of Barnes, thinking that it owed them nothing but that they had one-third of the contingent fee. It is not necessary to consider whether the lien attached to what we have called the *res,* before the fund was received, as a covenant to set apart rents and profits creates a lien upon the land. *Legard* v. *Hodges,* 1 Ves., Jr. 477. It is enough that it attached not later than that moment."

In the case at bar, the Butterworth-Judson Co. promised that if, when, and as soon as, it received the identified fund of $1,500,000, it would be set aside in a special account and be applied only for specified benefits to the United States. At the moment the fund was received the contract attached to it as if it were made at that moment. The promise of the Butterworth-Judson Co. created a lien upon the fund on the authority of the above quotation.

In *Hauselt* v. *Harrison,* 105 U. S. 401, Hauselt advanced money for the purchase of skins which

one Bayer agreed to tan and deliver to Hauselt, who was to sell them and return the proceeds, less commissions and advance to Bayer. It was agreed that the skins should be considered as security for the moneys advanced by Hauselt. Bayer became financially embarrassed and it was agreed that Hauselt should take possession of Bayer's tannery and finish the tanning of the incompleted skins. It was held that Hauselt had an *equitable lien* on the skins, although Bayer had bought and paid for the skins and had them in his own tannery. It was conceded that the title to the skins was in Bayer. This Court held that Hauselt had something more than Bayer's mere promise; and that Hauselt had an equitable lien on the skins, saying:

> "Nor can it be reasonably doubted that this equitable lien was capable of enforcement. If Bayer had, *in disregard and violation of his agreement, undertaken to divert the skins, whether in a finished or unfinished state, to some other and unauthorized use,* it would have been in fraud of the rights of Hauselt, *and a court of equity would not have hesitated by an injuncion to prevent the commission or continuance of the wrong.* Bayer would, under such circumstances, be treated by a court of equity *as a trustee,* fraudulently dealing with and misappropriating trust property, and Hauselt would be protected in his rights, as owner of a beneficial interest in the property, entitled to the enjoyment of the specific fruits of the agreement. * * *
>
> It is quite true that Hauselt could not have compelled Bayer, by an action at law, to deliver to him possession of his tannery and its contents; nor could he have recovered possession of the skins, tanned or untanned, by

force of a legal title; but it is equally true that, in equity, he could, by injunction, *have prevented Bayer from making any disposition of the property, inconsistent with his obligations under the contract;* and upon proof of his inability or unwillingness to complete the performance of his agreement the court would not have hesitated, in the exercise of a familiar jurisdiction, to protect the interests of Hauselt, by placing the property in the custody of a receiver for preservation, with authority, if such a course seemed expedient, in its discretion, to finish the unfinished work, and ultimately, by a sale and distribution of its proceeds, to adjust the rights of the parties."

This case is direct authority for the proposition that, if the Butterworth-Judson Co. had sought to use the advance payment for foreign purposes, the Government had such an equitable interest in the fund as to sustain an injunction to prevent its diversion; and it was not remitted to an ordinary action at law for damages.

That point being conceded, it establishes an *equitable lien* in favor of the United States, which is fatal to the alleged right of set-off in the Banks.

By the contract in the case at bar, there was an absolute and exclusive appropriation by the Butterworth-Judson Co. of the funds deposited in the special account for the single purpose of paying for the plant and the munitions, in default of which it was to be returned to the United States. It was a much more definite appropriation than that sustained in *Curtis* v. *Walpole Tire Co.*, 218 Fed. 145, 148 (C. C. A., 1st Cir.).

It was entirely competent for the United States and Butterworth-Judson Co. to contract with ref-

erence to a specific fund; and for the Government to surrender the possession of and the title to such fund, and yet to require as a condition of parting with the money, that the fund should be kept in a special account, separate from all other funds, and devoted to a specific object only. This gave to the United States a right to have the thing itself, *i. e., the fund,* devoted to the purposes specified. This right over the fund is generally called an *equitable lien.* It is a right capable of enforcement in equity and is good not only as against the Butterworth-Judson Co., but against all persons taking the fund with notice of such reserved right. An equitable lien is "intensely undefined" (*Brunsdon* v. *Allard,* 2 El. & El. 19) and is "liberally extended in modern times to facilitate mercantile transactions" (288 Fed. 349).

If the foregoing proposition be conceded, then it follows as a corollary that the Bank, having knowledge of this equitable lien, could not assert the right of "set-off" against it.

II. *The Banks having notice of the Government's lien, could not "set-off" the deposit against an indebtedness due them.*

The Banks knew all the facts concerning the deposits in the special accounts, the contracts under which they were made, and that the Butterworth-Judson Co. was required to ear-mark and keep the special accounts separate from all its other funds for the purpose of facilitating the construction of the plant and carrying out the obligations imposed by its contract with the Government (R. 29, 30).

It is elementary that when a Bank has notice of the trust character of a deposit with it, it cannot, as against the true owner or person having a beneficial interest in or lien on the deposits, appropriate or claim the deposit as a set-off against a personal obligation of the Trustee-depositor to the Bank (3 Ency. U. S. Sup. Ct. Rep. 25; *7 Corpus Juris*, p. 660; *National Bank* v. *Insurance Co.*, 103 U. S. 783; *National Bank* v. *Insurance Co.*, 104 U. S. 54, 64, and cases therein cited; *Allen* v. *St. Louis Bk.*, 120 U. S. 20, 40; *Union Stockyards Bank* v. *Gillespie*, 137 U. S. 411, 416, 419, 420, 423; *ex parte Kingston*, 6 L. R. (Ch. Ap.) 632; *Gable Savings Bank* v. *National Bank of Commerce*, 64 Neb. 413; 89 N. W. 1031; *Baker* v. *New York Nat. Bank*, 100 N. Y. 31; 2 Michie on Banks & Banking, § 134; 1 Morse on Banks and Banking, 5th Ed., § 326 (*f*) 334; *Allen* v. *Puritan Trust Co.*, 211 Mass. 409; 55 L. R. A. (n. s.) 518, 525 monographic note; *Walters National Bank* v. *Bantock*, 41 Okla. 153, citing many authorities: 3 R. C. L. 593; *Clemmer* v. *Drovers Nat. Bk.* 157 Ill. 206; *Burtnett* v. *First National Bank*, 38 Mich. 630, 635; *Boylen* v. *N. W. Nat. Bank*, 125 Wis. 498; *Emigh* v. *Earling*, 134 Wis. 565).

SECOND POINT.

The Banks accepted the deposit with full knowledge that the Butterworth-Judson Co. made the deposit for the express purpose of having the money applied by its own checks to certain specific purposes.

Therefore, the Banks cannot assert the right of set-off against the deposit.

1. The Banks, at all times, knew that the $1,500,000, and any replenishments thereof, were in special accounts, separate and distinct from all other property and funds of the Butterworth-Judson Co.; that it was required to be kept so differentiated, ear-marked and distinct; that the deposit had been made for the purpose of facilitating the construction of the picric acid plant under the terms of the Principal Agreement of May 9, 1918; and that by the terms thereof the Butterworth-Judson Co. could only use the money in payment of expenditures for building the plant, or for manufacturing the acid for the Government as required by that contract (R. 30, 65).

2. The deposits were accepted by the Banks with full knowledge that the depositor (1) expected to check the money out for certain specific purposes only, and (2) was under express contract *not* to check the money out for any other purposes whatever.

By accepting the deposits with such knowledge of the Butterworth-Judson's intention as to its specific application, the Banks thereby waived, or are estopped to assert. any right of set-off against

such deposit on account of any indebtedness owing by the Butterworth-Judson Co. to the Banks.

3. This is not a case of what is often called a "special deposit" where something is left with the bank as bailee and the identical thing so deposited must be returned to the depositor.

This is a distinct class of deposit, where the depositor deposits money with the bank, title thereto passes to the bank as in the case of the ordinary general deposit, but where the depositor, *at the time of making the deposit, notifies the bank that the money is deposited for the purpose of being applied, by the depositor himself through the medium of checks drawn against it,* to some special object or purpose.

That is the case at bar.

It must be clearly differentiated from those cases (*a*) where the deposit, say, a bag of gold, is left with the bank which must return the identical physical gold, or (*b*) where money is deposited in a bank with instructions *to the bank itself to act as agent* for the depositor in applying the money to a designated purpose.

The present case belongs to an entirely different class, where the knowledge of the bank of the purpose to which the depositor has dedicated the money, and the acceptance of the deposit with such knowledge, prevent the bank from asserting its right of set-off, so as to defeat the application of the money to the designated purpose.

4. The Banks might have declined to accept the deposit. But when, instead of so declining, they accepted the deposit with the knowledge that it was deposited for certain specific purposes only,

the Banks cannot interpose any claim of their own in conflict with such specific purposes.

The Butterworth-Judson Co. had a right to determine the application of the money so deposited and accepted.

The fact that the Butterworth-Judson Co. had a right to check the money out (without countersignature on the checks of any other party), does not affect the question nor enlarge the right of the Banks to disregard the terms on which the deposit was made and accepted.

5. If, then, a bank cannot "set-off" its indebtedness against such a deposit, where *the depositor* determines the purposes for which he will check the money out, *a fortiori*, the banks cannot set off their indebtedness where the deposit is made by the depositor, *pursuant to a contract with the person furnishing the money* which stipulates that the money should only be checked out for certain specific purposes.

6. Eliminating, for the moment, the rights of the Government under the requirement that the money should be deposited in a special account, we have a case where the Butterworth-Judson Co. itself had the right, on depositing money to its credit, to notify the Bank that such deposit was put there for the purpose of being used by the Butterworth-Judson Co. for certain specific purposes only, and when the Bank accepted the deposit on those terms, it became bound thereby and could not seize the money in order to apply it to any other purpose.

THE BANKER'S RIGHT OF "SET-OFF".

(*a*) In the ordinary case of a deposit of money in bank, the relation of debtor and creditor arises (*Marine Bank* v. *Fulton Bank,* 2 Wall. 252; *Burton* v. *U. S.,* 196 U. S. 283, 301, and cases there cited).

The obligation of the bank is simply to repay the money on demand, as evidenced by the depositor's check drawn against the deposit; and (in the absence of notice to the bank that the depositor is guilty of some breach of trust in withdrawing the funds) the bank is not concerned with the application of the money (3 Encyl. U. S. Sup. Ct. Rep. 27; *National Bank* v. *Insurance Co.,* 104 U. S. 54, 65; *Union Stock Yards Bk.* v. *Gillespie,* 137 U. S. 411, 416; *Bodenham* v. *Hoskins,* 13 Eng. L. & E. 222; *U. S. F. & G.* v. *Adoue,* 104 Tex. 379).

(*b*) From that relation of debtor and creditor, there arose (1) by the law merchant the so-called banker's lien on securities and valuables in his hands, and (2) the right to set off a deposit against an indebtedness due the Bank (3 R. C. L. 589; *Brandao* v. *Barnett,* 12 C. & F. 787, 805, 806; *Shuman* v. *Citizens State Bank, 27* No. Dak. 599; *Wagner* v. *Citizens Bank,* 19 Ann. Cas. 483, 487 and monographic note).

(*c*) But this right of set-off is not absolute and unconditional. There are limitations upon it. *It does not exist* where the deposit *was made for a specific purpose* or under circumstances *inconsistent* with the existence, continuance or application of the right of set-off (*Reynes* v. *Dumont,* 130 U. S. 354, 390, 391; *Hanover Nat. Bank* v. *Sud-*

dath, 215 U. S. 110, 116; *Callaham* v. *Bank of Anderson,* 69 S Car. 374; 2 Ann. Cas. 203, 206 and monographic note); or if the deposit is *specifically applicable* to some other particular purpose (7 Corp. Jur., pp. 631, 632 n 10, 660; 3 R. C. L. p. 595 n 17).

In 3 R C. L., p. 595, it is said:

> "The right of the bank to apply a deposit to the payment of matured indebtedness on the part of the depositor to the bank, does not exist in the case of a special deposit or *a deposit for a specific purpose inconsistent with the right of application or set-off.*"

At page 588, the bank's right of set-off is recognized

> "provided there is no express agreement to the contrary and the deposit is not *specifically applicable to some other particular purpose.*"

In 2 Michie on Banks and Banking, § 134 (4) it is said:

> **"Deposits made for special purposes.** It is a general rule that funds deposited in a bank *for a special purpose,* known to the bank, or under a special agreement, can not be withheld from that purpose, to the end that they may be set off by the bank against a debt due to it from the depositor.
>
> **A custom among banks to apply deposits for special purposes** to debts due the bank from the depositor does not authorize such application.
>
> **Deposits to pay Designated Debts.** A bank does not have a lien upon special deposits of moneys deposited for the payment of a particular designated debt."
>
> **Deposit to meet Outstanding Checks.** A bank receiving a deposit with notice that

it is made to meet outstanding checks may not charge the depositor's account with a debt due it from him."

Again, page 1040:

"It is only where there gather around any particular deposit, or line of deposits, circumstances of a peculiar nature, which *individualize* that deposit, or line of deposits, and inform the bank of *peculiar facts of equitable cognizance* that it is debarred treating the deposit as that of money belonging absolutely to the depositor. The knowledge which *peculiar circumstances* casts upon a bank in respect to particular deposits is not limited to the character of the business of the depositor, that of commission merchant, *but extends to its results.*"

That language was adopted as the law of this Court in *Union Stock Yards Bank* v. *Gillespie,* 137 U. S. 411, 416.

In Morse on Banks and Banking (5th Ed.), § 325, p. 611, it is said:

"Any special purpose attaching to the deposit *inconsistent* with a general lien will prevent it, * * *".

§ 325 (*b*) "No General Lien if Bank has Notice of Facts Inconsistent with it, as a Special Purpose in the Deposit. "(*b*) In *Bank of United States* v. *Macalester,* the general rule was laid down that funds deposited in a bank for a special purpose, known to the bank, cannot be withheld from that purpose, to the end that they may be set off by the bank against a debt due to it from the depositor. Accordingly, certain coupons of the State bonds, issued by the State of Illinois, having been made payable at the Bank of the United States, and funds to pre-

cisely the amount necessary to meet these coupons having been deposited by the State in the bank just before they fell due, it was held that the bank, understanding the purpose of the deposit, could not refuse to apply the money to the payment of the coupons on the ground of a prior undischarged indebtedness of the State to the bank. The same general rule is laid down by Grant in his English Treatise, p. 372. He says that the claim of a general lien by the bank would be inconsistent with its special undertaking.
* * *

The English cases eliminate from the operation of the lien all property which comes into the banker's hands plainly earmarked or *appropriated for any special purpose.* A customer's security, specifically stated to be for the amount 'which shall or may be found due on the balance of his account', was held to be security for the then existing balance only, and not to be applicable upon the subsequent floating balance. In like manner, a security specifically given for a contemporaneous advance of one thousand pounds by the banker, was held not to be applicable against an independent indebtedness of five hundred pounds, afterwards arising upon the ordinary running account."

In 1 Morse on Banks and Banking, § 325 (*d*), it is said:

"Specific Deposit can not be appropriated to debt of the Depositor to Bank. Money deposited *for a specific purpose* must be applied to that and no other. Where a State had two deposits in a Bank, one to pay coupons and bonds issued by the canal commissioners, the other under control of the fund commissioner, the latter being overdrawn, the bank applied the former deposit

to settle the deficit. *Held,* that this could not be done by the Bank; it was the agent of the coupon holders to the extent of the sum set apart for their payment."

p. 626, it is said:

"And if there is any circumstance *inconsistent with the claim of a lien,* it will not be upheld, as where securities are delivered to a bank for a specific purpose."

In *German National Bank* v. *Foreman,* 138 Pa. State, 474, the Court explained that the meaning of the limitation of the right of the depositor to deposit his money for a special purpose, was this:

"It means merely that where a depositor has made a *special* application or *appropriation of his balance and so notifies the Bank,* the latter cannot charge off the note against his deposit. *This arises from the fact that a man may do what he will with his own, so long as he retains control of it."*

In *Masonic Savings Bank* v. *Bangs' Admr.,* 84 Ky. 135, 139, it is said:

"It is equally as well settled that when the deposit is made for a special purpose, with the knowledge and undertaking of the bank, that purpose must be carried out."

The English rule as established in *Brandao* v. *Barnett,* 12 C. & F. Rep. 787, 786, *Bock* v. *Gorissen,* 30 L. J. (ch) 39, and *T. H. Greenwood Teal* v. *William Williams Brown & Co.,* 11 T. L. R. 56, and as adopted by this Court in *Reynes* v. *Dumont,* 130 U. S. 354, 391, is that a banker's lien or right of set-off will not arise where the deposit or security has been accepted by the

banker under conditions *inconsistent* with the claim of a lien or right of set-off.

A chronological review of the authorities covering this particular special class of deposits will show the development of the law. We will exclude therefrom those powerful cases which might be said to be based on the existence of a trust (*National Bank* v. *Insurance Co.,* 104 U. S. 54) and those where the Bank itself agreed to disburse the money as agent of the depositor ( ).

The principle for which we contend is a development of the past fifty years and can best be understood by a

CHRONOLOGICAL REVIEW OF THE AUTHORITIES.

In *Wilson* v. *Dawson,* 52 Ind. 513, 515 (1876), a depositor, being indebted to a bank, agreed with the bank that he would buy cattle, deposit the proceeds with the bank, give to the seller checks for the amount, and that the deposit should be applied exclusively to the payment of the depositor's checks to such sellers. The Court held that the bank had no right to set-off the deposit against a past due note, saying:

> "It is clear, we think, however, that as the money in question was deposited under a special agreement that it should be paid out and used only in satisfaction of the checks drawn in favor of the persons from whom the cattle, etc., had been purchased, from the sale of which by the principal in the note the money had been derived, it could not have been rightfully applied to the satisfaction of the notes on which the action is predicated."

The bank was not an agent to make the payment or application of the money, but it was simply to honor checks drawn in the ordinary manner against the account for a specific purpose. It may be suggested that the money deposited was a trust fund belonging to the owners of the cattle. The depositor was not a factor or agent, but a buyer. The Court put its decision upon the ground that, as the bank knew that the funds *were deposited for a special purpose*, it could not prevent the carrying out of such purpose, saying:

> "It is a general rule, that funds deposited in a bank for a *special purpose*, known to the bank, cannot be withheld from that purpose, to the end that they may be set-off by the bank against a debt due to it from the depositor. The claim of a general lien by the bank would be *inconsistent* with its special undertaking. Morse on Banks & Banking, 34 *et seq.*, and authorities cited; *Bank of U. S.* v. *Macalester*, 9 Pa. St. 475. * * * Had it not been for the special agreement made by the bankers, *it may be presumed the money never would have been deposited with them.*"

In *Straus* v. *Tradesmen's National Bank*, 36 Hun, 451 (1885), one Dixon gave his accommodation check for $11,775 to the plaintiffs when there were no funds in bank to meet it. The plaintiffs sent their certified check to the bank with instructions to deposit it to the credit of Dixon in order to meet the check Dixon had given the day before. The bank deposited the check to Dixon's credit and then proceeded to offset a portion of the deposit against a debt Dixon owed the bank. The Court held that as the bank *accepted* the deposit to Dixon's credit *knowing that it was intended to meet a check* Dixon had previously

drawn, it could not set off the deposit against its own indebtedness, saying:

> "From this statement the fact clearly appears that the plaintiffs' check was deposited with the Tradesmen's National Bank to the credit of Dixon, solely for the purpose of paying the check received from him by the plaintiffs. And the bank having so received it, *understanding that to be the intent and object of its deposit, legally accepted the trust created by the transaction and became obligated to appropriate so much of the plaintiffs' check as should be required for that purpose to the payment of the check loaned to them by Dixon.* It was *not necessary* for the creation of this obligation that the officers of the bank should *expressly agree* so to use and apply the plaintiffs' check. The obligation to do that very clearly arose out of the delivery of the check to the bank *with notice that such was the object of its delivery without any concurrent promise on the part of the officers of the bank to carry that object into effect.* Their conduct was such as to disclose their *acquiescence* in the purpose for which the check was delivered and received, and out of that the obligation plainly arose to apply its proceeds solely and specially as the plaintiffs intended they should be applied. A *trust* to this extent was created in the plaintiff's favor, and the bank had no right or authority to use any part of the proceeds of the check for a different object. (*United States* v. *State Bank*, 96 U. S. 30, 35; *National Bank* v. *Insurance Co.*, 104 U. S. 54; *People* v. *City Bank of Rochester*, 96 N. Y. 32, 37.)"

This judgment was ultimately affirmed in 122 New York, 379 (1890), when the Court said:

> "* * * it must be assumed that the defendant had notice that the deposit was spe-

cially made to supply a fund to pay the Dixon check. This check had been indorsed by the plaintiffs, and placed to their credit in the Hanover Bank, when their check on that bank was certified. And, as between them and Dixon, the latter had no right to divert the fund produced by the deposit in the Tradesmen's Bank from its purpose and subject them to liability upon the indorsement so made of his check. The plaintiffs' check represented their money, and was deposited with the bank to carry out their agreement with Dixon; and this being accomplished they would also be relieved from liability as such endorsers. When the defendant received it, with notice that the deposit was made to pay a check given by Dixon to the plaintiffs, it was denied the right to treat the fund as a general deposit on Dixon's account; and it must be deemed to have been placed to the credit of Dixon subject to the qualified purpose or trust on which the defendant was then advised the deposit was made. *Van Alen* v. *Bank*, 52 N. Y. 1; *People* v. *City of Rochester*, 96 N. Y. 32; *National Bank* v. *Insurance Co.*, 104 U. S. 54."*

n *Fitzgerald* v. *State Bank*, 64 Minn. 469 96), a firm became insolvent, the creditors met, uding the cashier of a bank and it was agreed during the absence of the senior member of firm in Europe, one Miller should carry on the ness, collect in the assets, deposit the money ne bank and not pay out any money upon the ting indebtedness of the firm. The Court

*It may be suggested that the Bank was an active t to apply the deposit. But it was not to do anyg except, as here, to place the deposit to Dixon's unt so as to meet his check when presented.

held that the bank could not off-set a deposit against a debt it held against the firm. The Court said:

> "It was in the nature of a special deposit for a *well understood purpose and object.* Certainly good faith and fair business dealing require that the amount of this deposit shall not be so diverted as to give a party to the agreement a preference over other creditors. So the question is whether the law will permit the bank which received the money under such circumstances to set off notes held by it against the insolvent firm to the amount of the deposit, and thus indirectly obtain a preference. If this could be done, the plainest principles of *equitable estoppel* would be disregarded, for undoubtedly the acts and conduct of the cashier, when present at and presiding over the meeting, influenced other creditors, and they were of such a character that to allow the bank to now repudiate them, or any part of the transaction, and to appropriate the amount of the deposit in part satisfaction of its notes, would be rank injustice, necessarily resulting in injury to the creditors who participated in the meeting and in the agreement, as well as to all other creditors of the insolvent firm. The money acquired by Miller belonged to all of the creditors, and the nature of the agreement under which Miller obtained and placed it in defendant's custody shows that the cashier understood and recognized the fact. The Bank cannot now dispute the right of the assignee to the money."

In *Carter* v. *Martin*, 22 Ind. App. 445 (1899), an owner agreed with a contractor to make an *advance payment* on account of a building which the contractor was erecting for the owner. The

contractor deposited it in bank under an agreement that the contractor should check against it for the payment of material and labor going into the building. The bank knew at the time of receiving the deposit that the contractor had received it as the first payment on the contract and that he had no other means with which to pay for the material or labor on the building.

The Court held that the bank could not treat that deposit as a payment of a debt owing by the contractor to the Bank, saying:

> "When appellees [bankers], received said money from McCormick under said agreement to pay it out upon his order in satisfaction of certain claims, they lost all control of it, so far as disposing of it in any other manner than as was agreed at the time the money was received. * * *
>
> Nor does this view of the law, as applicable to the facts in the cause, in any way conflict with the well-settled rules of law as applied to banks. Appellees were doing a banking business. They accepted the $575 from McCormick as a deposit, but they accepted it under a special agreement as is shown by the finding of facts. Where one indebted to a bank makes a general deposit, the bank may appropriate such deposit to the payment of said indebtedness. Such right may be waived by the bank * * *."

In *Woodhouse* v. *Crandall,* 197 Ill. 104 (1902), it was held, that where a depositor deposited $1,500 with a bank which knew that the deposit was made pursuant to a lease by which the depositor was to deposit the money to secure performance of the lease, the banker had no general lien. The money was mingled with the banker's general funds, but was held that it is the ***fund,*** not the ***particular bills,***

which is subject to be followed, traced and identified. The Court said:

> "The material question in this case, therefore, is whether the trust fund deposited by Furlong can be traced and identified, and upon that question the law is well settled that it is not necessary the money or bank bills should be identified. The suit is not to recover a specific thing, such as particular pieces of money or bills, but a certain sum of money held in trust, and *it is the identity of the fund,* and not the identity of the money or currency which is to be established.
>
> It makes no difference, then, in tracing this fund, that the original package of bills was not preserved, but the question is whether the *trust fund* can be followed and found. * * *
>
> Again it makes no difference on the question of identity that the fund was mingled with other moneys of the bank. That question was also settled in *Kirby* v. *Wilson,* 98 Ill. 240, where it was held that the identity of the fund is not destroyed and lost merely by being mingled with other moneys of the trustee."

In *Lynam* v. *Belfast Nat. Bank,* 98 Me. 448 (1904), a corporation got in financial difficulties, the creditors met, at which a bank was represented. Before any bankruptcy proceedings were started, the company deposited $800 in the bank with the intention (although not communicated to the bank) that the money should be held for its trustee in bankruptcy when he should in the future be appointed. The Court held that the bank could not off-set a debt against the deposit, saying:

> "Since June 10th the granite company had ceased to be a going concern, and all its efforts and that of its creditors had been to obtain a distribution of its assets equitably,

and to that end the first attempt was to discharge the attachments. Honest dealing on the part of the granite company, which is to be presumed, required that all its assets should be husbanded for the benefit of all of its creditors. Pending the effort to obtain an assignment or adjudication of bankruptcy, it had $800 in money, which it intended to retain, and ought to retain, as part of its general assets. As some time would elapse before it could be thus administered, it was deposited in the bank, really for safekeeping. All these facts were well known to the bank when it received the deposit. It knew it was not intended as a payment, and did not treat it as such. The bank could not fail to understand that it was intended that this money should be added to the other assets for the general benefit, as it equitably ought to be. It certainly understood that the granite company, under the then existing circumstances, *would not voluntarily subject this portion of its assets to a set-off by the bank, to the injury of other creditors.*

Upon consideration of all the circumstances, and the situation of the parties, we think it a fair inference that the bank understood that the deposit was intended only for safekeeping, to be ultimately appropriated for the benefit of all the creditors of the granite company, and that in fact it was a deposit in trust for that purpose. And it being charged with such trust, the plaintiff, as trustee in bankruptcy, is entitled to recover."

In the case at bar, Counsel for the Banks attempted below to distinguish the *Lynam* case by saying that the bank

> "had knowledge of the existence of a fiduciary relation between the depositor and a third party [the Trustee in bankruptcy] and hence could not offset the account."

Such is not the case.

At the time the bank received the $800 deposit, no Trustee in bankruptcy had been appointed, no bankruptcy proceedings had been started, and no fiduciary relations existed between the depositor and any third person, and the deposit was made with the simple statement "Enclosed find deposit credit S G Co. $800" and was treated as an ordinary deposit. The right of set-off was denied, however, upon the ground that the Bank, although not expressly notified, must have known that the deposit was not made with the intention of letting the Bank appropriate it, but was intended to be held for future disposition by a Trustee in Bankruptcy if and when he should be appointed.

The attempted differentiation fails, and the case is directly in point. The right of set-off was denied because, on the facts, it was held that the bank must have known that the depositor *did not intend* the deposit as a payment of the Bank's debt. *A fortiori,* in the case at bar, the Banks knew that the deposit of the advance payment was not intended to be applied to the Butterworth-Judson Co.'s debts or general purposes, but was by contract specifically required to be segregated and held for the specific purpose of meeting the expenditures in the erection of the plant and the manufacture of picric acid.

In *First National Bank* v. *Barger,* 115 S. W. 726 (1909), one Coldwell drew four checks upon a bank in which he had no funds, and to which he was already indebted. He met the President of the bank in a different city, gave him another person's check for the exact amount of the checks issued and asked him to place it to his (Cold-

well's) credit; and he told the President of the checks he had drawn which would be protested if they reached the bank before the one he handed the President. The President mailed the check to the bank without any statement of the purpose of the deposit. Upon the return of the President to the bank, the check was credited to Coldwell and against it was charged the prior indebtedness.

The Court held that the bank could not set-off the indebtedness against the deposit, because it received the deposit with notice that it was made for the purpose of meeting certain outstanding checks drawn by the depositor.

The Court said:

> "The law is that, if a bank received a general deposit from one who is indebted to it, the bank has the right to charge the depositor's account with such indebtedness; but if the bank received a deposit with notice *that it is made for the purpose of meeting outstanding checks* drawn by the depositor, it has no right to charge the depositor's account with sums due it by the depositor, and thus defeat the person holding the outstanding claims from collecting their checks. This rule applies only when the bank has *notice* of the previous appropriation of the sum deposited, or, in other words, that it is a special deposit to meet outstanding checks issued by the depositor."

In the case at bar, the Banks knew when they accepted the "special account" deposits that, by contract between the United States and Butterworth-Judson Co., the $1,500,000 deposited had been dedicated to a specific purpose, *i. e.,* to meet payments for building the plant and making the acid thereat.

In *Wagner* v. *Citizens Bank, etc., Co.*, 122 Tenn. 164 (1909), a furniture company became financially embarrassed. The local creditors, including a bank, met, and with the consent of the officers of the company, agreed that the assets should be converted into cash, and be deposited to the company's credit in the bank; that out of the deposit they would pay current expenses and satisfy the claims of any persistent creditors, and then after the accumulation of sufficient funds had been made, the funds should be divided among local and foreign creditors *pro rata*. Checks were to be signed by the President of the Furniture Co. and countersigned by a representative of the Creditors' Committee.

The proceeds of all sales were deposited in the bank. The bank attempted to set off the deposit against an indebtedness due it by the Furniture Company. The Court (citing many authorities) stated that the general rule was that the relation between a bank and a depositor was that of debtor and creditor, and that a bank could set off a deposit against an indebtedness; but the Court (reviewing various authorities, some of which are noticed above) denied the right of set-off upon the ground that the bank knew when it accepted the deposit

> "that this fund was being deposited with it as a special fund for *pro rata* distribution among all the creditors of the Wilcox Furniture Co."

After distinguishing certain cases asserting the ordinary rule of set-off, the Court concluded:

> "We are therefore of opinion that the bank is *estopped*, by its conduct and by its agreement with the other creditors, from asserting

any right to a set-off against the funds derived from the sales of the stock of the Furniture Company."

In *Smith* v. *Sanborn State Bank,* 147 Ia. 640 (1910), a depositor left with a bank a $200 Bill of Exchange, telling the bank that he desired to use the money (*a*) to pay a $40 rent claim held by the bank for collection, and (*b*) the remainder to pay the medical expenses of his wife who was to be sent to a hospital in a distant city the next day. The bank told the depositor that the safe was locked for the night, but that he could leave the Bill of Exchange as a deposit, together with a check for $43 to cover the rent claim and another $3 indebtedness to the bank, and that the remainder could be drawn by him as the money might be needed in the treatment of his sick wife. Later the bank charged up the remainder of the deposit against a promissory note which the depositor owed to the bank.

It should particularly be noticed that the bank did not itself undertake to pay out, as agent, any money for and on behalf of the depositor, but that it merely told him that he would be able to check on the account for the purposes that he wished to accomplish in making the deposit. This is a direct analogy to the case at bar where the Banks accepted the deposit with full knowledge that the Butterworth-Judson Co. was going to check out the money for certain specific purposes as required by its contract.

When the Banks accepted the deposit with that knowledge, it was equivalent to an agreement by them that the Butterworth-Judson Co. could check the money out for such purpose.

In holding that the bank had no right to set-off the deposit against the note, the Court said:

> "Of the general rule that a bank to whom a depositor is owing a matured indebtedness may appropriate the general deposit of its debtor to the discharge of the obligation, there can be no doubt. *Aetna Nat. Bank* v. *Fourth Nat. Bank,* 46 N. Y. 82, *Knapp* v. *Cowell,* 77 Iowa, 528. But it is no less certain that a deposit *made for a special purpose,* or under a special agreement, cannot rightfully be so appropriated. *Wilson* v. *Dawson,* 52 Ind. 513; *Straus* v. *Tradesman's Nat. Bank,* 122 N. Y. 379; *Judy* v. *Farmer's & T. Bank,* 81 Mo. 404; *Bank of United States* v. *Macalester,* 9 Pa. 475; *Masonic Sav. Bank* v. *Bangs,* 84 Ky. 135. Indeed, the proposition that a bank enjoys no exemption from the general rule by which every party to a business transaction or agreement is legally bound to respect the obligation of his contract is one which ought to require neither argument nor citation of authority. The evidence shows without dispute that the check for $200 was placed with the defendant upon the express agreement and understanding that, after paying certain specifically named debts, the remainder would be repaid to the plaintiff on the following day, or whenever called for, to enable him to take his wife to the hospital for needed treatment. Upon money so received, no lien attached in favor of the bank, and its attempt to appropriate the same was wholly without right or authority. Upon such a record plaintiff was clearly entitled to recover."

In the case at bar, when the Banks accepted the $1,500,000 "special account" deposit, with knowledge of the terms on which alone the depositor [Butterworth-Judson Co.] was authorized to de-

posit, they *impliedly agreed* to such terms, became bound to honor the depositor's checks, and renounced their right of set-off, which could not attach to funds so accepted.

In *Dolph* v. *Cross,* 153 Ia. 289 (1911), a man drew a check upon a bank, and thereafter deposited funds in the bank to meet the check, telling the bank that the funds so deposited were deposited to meet the payment of checks already drawn. The bank refused to honor the checks when presented, on the ground that an intermediate garnishment had been served.

In holding that the deposit could not be reached by the attaching creditor of the depositor, the Court said:

> "The bank officials understood that they received this money for the *express purpose* of paying checks already issued for that exact amount. Whether the facts pleaded show an equitable assignment to the check holders we need not determine. The deposit was special, and not general. It was made for the benefit of the particular check holders. The bank received it as such. It is enough to say that the contract of deposit was made for the benefit of third parties, and that such third parties were entitled to avail themselves of it. *If the bank itself had been a creditor of the depositor, it could not have applied such deposit upon its own claim.* * * *
>
> *The bank, having received the deposit for such specific purpose, was bound by the conditions imposed.* * * *
>
> We reach the conclusion that the deposit in question was *special,* and not general, and that it did not create the mere relation of debtor and creditor between the bank and the depositor in the ordinary sense, and that the

> right of the check holders, for whose benefit it was deposited, was superior to that of the garnishing creditor, and that the claim of the intervenor thereto to the amount of his check should have been sustained."

In *Walters Nat. Bank* v. *Bantock,* 41 Okla. 153 (1913), a Realty Company deposited $1,000 to its credit. The bank was notified that this deposit was made so that the Realty Company could give its check against it, to be held with a check of like amount by another man to insure the faithful performance of the contract for a sale of real estate. Later the bank "set-off" against the deposit an indebtedness it had against the Realty Company.

The Court held that this could not be done, because the Bank knew the purpose for which the $1,000 deposit was made, and had assured the parties that when checked on, the check would be paid.*

In *Peterson* v. *Crawley,* 38 So. Dak. 597 (1917), by agreement between a mortgagor and mortgagee, $800 of the proceeds of fire insurance on the mortgaged property, was turned over to a bank cashier to be deposited in his name and to be used by the mortgagor for the purpose of erecting a new house on the premises. Later, the mortgagor determined not to rebuild and sent to the mortgagee a check for $800 drawn on the bank as a partial payment on the mortgage debt. The bank refused to honor the check upon the

* If it be suggested that the bank expressly promised that the check would be honored when presented, we respond that such promise is no more effective than the Banks' implied promise, on receiving the Butterworth-Judson Co. deposit, to honor checks drawn against it.

ground that it had set off the deposit against a debt owing it by the mortgagor. The Court held that, as the money was deposited with the bank *for the sole purpose of being applied to the erection of a house on the mortgaged premises,* the mortgagor had the right to direct that the amount so deposited should be applied to the reduction of the mortgage indebtedness.

The Court said:

> "The evidence conclusively shows that the Cashier Randall, was fully advised as to the purpose for which the deposit of $800 was made in his name, and that it was not a deposit for the use and benefit of Crawley himself nor the Bank. The bank itself was charged with this knowledge of its cashier, and had no more right to appropriate this deposit to its own use than would Randall himself. The bank accepted the deposit with full knowledge, that the same was not intended to become, and did not become, any part of Crawley's personal funds or deposit, and the fact that the fund was so deposited in the name of Randall, its cashier, gave the bank no right to appropriate the deposit in satisfaction of Crawley's indebtedness to the bank. It is clear that neither the bank nor Randall, the cashier, had any interest in or control of the fund so deposited, *except such as was expressly conferred by the agreement of Mrs. Peterson and Crawley.* We are of opinion that this fund constituted a *special deposit* in Randall's name for the sole use and benefit of Mrs. Peterson and Crawley, and that they had the legal right to dispose of it, as they did, in applying it in part payment of plaintiff's mortgage. The record conclusively shows that Mrs. Peterson and Crawley *had agreed to this application of the*

> *fund* long before any attempt was made by the bank to apply it in satisfaction of Crawley's indebtedness to the bank."

In *Lehigh Valley Coal Sales Co.* v. *Maguire,* 251 Fed. 581 (1918), a seller refused to ship any coal unless paid for in advance. The purchaser sent an order for coal and a certified check in payment. The purchaser went into bankruptcy. The seller refused to ship the coal and retained the check as a credit upon an outstanding indebtedness. The Court (C. C. A., 7th Cir.) held that this could not be so set-off. After distinguishing *N. Y. County Bank* v. *Massey,* 192 U. S. 138, which was an ordinary case of a bank and a depositor—debtor and creditor—the Court said:

> "But where a creditor receives money from his debtor, with instructions not to apply it on the debt, but to hold or use it for a specific purpose, the right of set-off does not exist, because the *creditor* has become, not the debtor of his debtor, but the *trustee of a specific trust*" citing various Federal cases.

In *Turkington* v. *1st National Bank,* 97 Conn. 303 (1922), Mrs. Johns bought some corporate bonds under an agreement that the money she paid for them would be deposited by the company in a separate fund in bank to be checked out by the company for the purpose of the construction and equipment of the mortgaged plant.

The deposit was duly made to the credit of the company in a separate or special deposit to be checked out only for the specified purposes. The treasurer of the corporation was also cashier of the bank, knew of the agreement between Mrs. Johns and the company-depositor and agreed that

the arrangement would be carried out. Later, the bank set off the balance of the deposit against a debt owing to it by the company. The Court held that the bank had no right to set off the deposit against its debt, saying:

> "It is too late for the bank to deny that it received this deposit as a *special deposit to be applied only to the purposes agreed on;* and even if it were found, as it is not, that the tobacco company was actually indebted to the bank in June, 1915, the law is well settled that in such cases a bank cannot assert a lien or set-off *inconsistent with its special undertaking.* Morse on Banking, § 325, and many cases cited.
>
> In this particular case Mrs. Johns still retained a *special property* in the fund. It is true that she had received her mortgage bonds, *but so long as the entire fund had not been applied to augment her security she had not received the entire consideration agreed for by the terms of the special deposit.* And in the meantime the fund was deposited with the bank which was a party to the agreement, and has had the use of the money in its business. That being the situation it is perfectly clear that the bank had no right to appropriate any part of the fund in satisfaction of a claimed indebtedness of the tobacco company incurred in the ordinary course of its business."

In the lower courts, counsel for the Banks attempted to distinguish the *Turkington* case by saying:

> "In the *Turkington* case, therefore, the bank received the money as a special deposit for certain purposes only. These having been fulfilled, and a balance remaining, the banks

had no right to appropriate the balance to the payment of a debt due itself from the depositor. The special objects having been performed, the balance had to be returned. This was *not a general deposit* to be drawn on by check of the depositor without restraint by the bank."

The attempted differentiation fails, because in the case at bar the Banks received the $1,500,000 special account deposit as absolutely for the specific purposes named in the contract as did the Bank in the *Turkington* case. The contract in the *Turkington* case is excerpted in the margin and is no more specific than the contract in the case at bar.*

In the case at bar the deposit was no more a general deposit (to be withdrawn by the depositor without restraint) than could be done in the *Turk-*

*DEAR MADAM: We hereby acknowledge the receipt of your certified check for $28,500 payable to our order, the same being in payment for thirty-first mortgage bonds of this company.

"It is understood and agreed by the company that the $28,500 aforesaid will be deposited in a separate fund in the First National Bank of New Milford and checked out only for the following purposes:

"(1) On account of the expenses of the construction of the new mill at Wellsville, where the plant is located.

"(2) On account of the purchase of machinery and other necessary equipment for the same.

"(3) On account of the repair, improvement or necessary equipment of the present factory and property at Wellsville now owned by the company.

"(4) Commission of brokers in connection with the sale of bonds to you.

Yours very truly,
(Signed) TOBACCO PRODUCTION COMPANY,
By E. J. STURGES, Treasurer.

"As cashier of the above bank I guarantee that the above will be carried out.

"E. J. STURGES, Cashier".

ngton case. In each instance, the bank had full knowledge of the promise of the depositor that he deposit should be kept in a separate fund and hecked out only for certain specific purposes. The Butterworth-Judson Co. had no more control ver the deposit than did the Tobacco Company n the *Turkington* case. In each case, the Banks ad the same, and no more, responsibility for the pplication of the money; and the same, and no ore, right of set-off in the one case than in the ther.

In *Continental National Bank* v. *Moore*, 299 ed. 270, 272 (1924), a purchaser of a merchant's tock of goods, deposited the money in a bank to he order of the merchant with instructions to ay it over to him on receipt of a bill of sale, reerving to the purchaser the option to recall the oney if claims in excess of a certain amount ere filed against the merchant. The bank aplied the deposit to the payment of one of its own ebts.

The Court (C. C. A., 9th Cir.) held that the ank could not do so, saying:

> "The right of set off attaches upon the moneys of a customer deposited with the Bank 'in the usual course of business for advances which are supposed to be made upon their credit'. Michie, Banks and Banking, § 134. As to the fund which represented the proceeds of the bankrupt's business, the relation between the appellant [bank] and the bankrupt [merchant] was not that of banker and depositor, but that of bailee and bailor. * * * As to the funds so placed in the control of the bank it is well settled that there was no right of set-off" citing four Federal cases not reviewed herein.

THIRD POINT.

Analysis of the opinion of the Circuit Court of Appeals, and a Response to certain contentions of the Banks.

I.

ANALYSIS OF CIRCUIT COURT OF APPEALS' OPINION.

The Circuit Court of Appeals held:

I. That the transaction was exactly what it purported to be, *i. e.*, payment in advance for things purchased and thereafter to be delivered (R. 313, 314); and that the relation between the United States and the Butterworth-Judson Co. was not that of principal and agent (R. 315) but was one of debtor and creditor (R. 317).

COMMENT: That is correct. But the creditor (U. S.) by express contract reserved a special right in the fund, enforcible in equity.

II. That the only security which the United States took for the $1,500,000 advance was (*a*) a demand note for $1,500,000 (R. 316) and (*b*) a $750,000 surety bond (*Id.*)

COMMENT: That view is erroneous because *incomplete*, as it *omits* any consideration of the *principal* security taken, *i. e.*, the deposit of the money in a *special* account, *separate* from all other funds, and the *obligation* (secured by the $750,000 surety bond) that it should *not* be used for any other purpose whatever.

III. That because (*a*) the so-called "collateral" note bore interest and (*b*) the Butterworth-Judson Co. reserved the right to repay, at any time, to the Government any outstanding balance of the advance, *therefore* the relationship was simply that of debtor and creditor (R. 316, 317).

COMMENT: So far as that argument tends to prove the relation of debtor and creditor, it may be conceded.

But the Banks draw a *different* conclusion from that of the Court of Appeals, namely:

First: The Banks contend that the requirement of interest not only establishes a debtor-creditor relation, citing numerous cases,* but that it also, *ipso facto,* negatives the idea of any sort of fiduciary element in the transaction.

To that it may be replied (1) that no interest *was* required, as the original contract expressly provided in Art. XVII that as to the interest, if any, required by the War Credits Board,

> "the United States shall *reimburse* the Contractor therefor as a part of its costs and expenses under this contract" (R. 50).

(2) that there is no inconsistency whatever between the payment of interest and the existence of a trust relationship, as a single example will demonstrate. A will might provide that the executor or trustee, a Trust Company, should, on all

**Pittsburgh Nat. Bank* v. *McMurray,* 98 Pa. St. 538; *Cottonwood Co. Bank* v. *Case,* 125 N. W. 298; *Martin* v. *N. Y. Mining Co.,* 165 Fed. 398; *Budd* v. *Walker,* 113 N. Y. 637; *Preston* v. *Brennan,* 135 Cal. 55; *Blair* v. *Follansbee,* 67 Ill. App. 144; *Estate of Sam'l Deaner,* 126 Ia. 701; *Price* v. *Dawson,* 111 Misc. 279; *Kerchaw* v. *Snowden,* 36 Ohio St. 181.

uninvested cash balances in the estate, deposited in its banking department awaiting distribution, or reinvestment, pay 2% on such daily balances. No one could contend that the payment of that interest negatived the existence of a trust or relieved the executor or trustee from any fiduciary liability.

It is submitted, therefore, that the Government's contention that the $1,500,000 was impressed with the character of a trust fund, cannot be summarily disposed of by saying that the Butterworth-Judson Company was to pay interest.

Second: The Banks contend the Butterworth-Judson Co.'s right to repay the advance at any time also negatives a trust relationship. Not at all. Any express trustee may stipulate that he can return the trust fund at any time. But, in fact, we do not here have to rely on a *formal express* trust. We have a fund where title and possession have passed, but where the grantor retains such a *special interest* in its disposition as to create an *equitable lien* in respect thereof, or at all events to impress the fund with certain characteristics of a trust.

It is thus seen that the positions of the Court of Appeals and the Banks are very different. The former relies on the provision for interest and a bond as establishing the debtor-creditor relation (which we concede); while the latter rely on such provisions as conclusive evidence that no fiduciary element can exist (which we dispute).

IV. That no trust fund was created, because there was "neither designated beneficiary nor a designated trustee who is not the beneficiary", cit-

ing a trust fund definition in *Brown* v. *Spohr*, 87 App. Div. 522, 529 (R. 317).

COMMENT: Without stopping to inquire as to the universal correctness of the definition quoted, it is sufficient to observe:

We are not dealing here with a formal trust fund, granted by A to B for the benefit of C, but we are dealing with that species of equitable right where, *as between the parties, and those taking with notice,* it is competent to contract with respect to personal estate, so as to create an *equitable lien,* enforcible by the injured party, in equity, without being remitted to an action at law for damages for breach of contract (see authorities cited, pp. 30-38, *supra*). But, as pointed out (p. 28, *supra*), many writers would hold the Butterworth-Judson Co., on depositing the money in bank, became (1) an express trustee of the *chose in action* [claim against the bank] for the benefit of the United States, and (2) charged with the fiduciary duty to apply the fund strictly to the purposes set out in the contract.

V. That no "revolving fund" was created (R. 317, 318).

COMMENT: While the provisions for the constant replenishment by the Government of the $1,500,000 advance, as fast as it was used in erecting, etc., the plant (Art. VI, R. 42; Art. VI, R. 65) might well be termed a "revolving fund", yet, in so far as the Court means to hold that the $1,500,000 became an advance payment to Butterworth-Judson Co., and did not remain exclusively Government money disbursed by it through the contractor as an agent, its position may be conceded.

VI. That the effect of the "special account" was not "to keep the title of advance payments in the United States" (R. 319).

COMMENT: That is conceded.

II.

RESPONSE TO BANKS' CONTENTIONS BELOW.

I. *"Special account" was not confined solely to erecting plant.* The Banks insisted that the $1,500,000 could be used (*after* the completion of the plant) in the production of the picric acid at the plant. *That is conceded by the Government,* but it is not observed how that helps the Banks' position.

II. *Duty of Banks to honor checks of Butterworth-Judson Co.* The Banks insisted that they were bound to honor any checks drawn by the contractor against the "special account" and rely on that fact as proof that no trust element existed. It is *conceded* that (in the absence of any express knowledge that the contractor was checking out the money in violation of its duty) the Banks would have to honor checks and were not bound to look to the application of the money. But how does that fact give to the Banks any right of "set-off" in conflict with (1) the equitable lien of the United States, or (2) its obligation, on accepting the deposits, to permit it to be used for the specified purposes?

III. *Special Deposit.* The Banks cited several authorities to show that a special deposit is one where the title never passes to the Bank, which is a mere bailee, bound to return the *identical thing*

deposited.* *That is also conceded;* but the case at bar is not one of special deposit in that sense, but it is one where the Bank accepted the deposit with knowledge (and hence with implied agreement) that it was to be applied only to certain specified purposes—and hence *inconsistent* with any right of "set-off".

IV. *Demand Note.* The Banks urged that the Butterworth-Judson Co. was to pay interest on the $1,500,000 note, and that the correlative promise of the Government to reimburse any interest required to be paid, did not prevent it from being a case where interest must be paid.

In addition to the response already made (p. 69, *supra*), it must be remembered that the United States agree (Art. V, R. 64):

> "The Government shall not negotiate nor demand payment of the note mentioned in the preceding article so long as the contractor is not in default under this agreement."

So there was no obligation under the note until default; and hence, so far as the "advance payment" was concerned the interest was automatically to be reimbursed by the Government.

V. *Right to repay.* The Banks urged that the Butterworth-Judson Co.'s right at any time to repay the advance negatived the idea of trust. The United States was at once the creator and beneficiary of the trust element. It could grant to the other party the right to return the money and terminate the trust relationship.

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* *C. J. 630 et seq.; Morse on Banking,* § 183-186; *Montagu* v. *Pacific Bank,* 81 Fed. 602; *Moreland* v. *Brown,* 86 Fed. 257; *In re Davis,* 119 Fed. 950; *State* v. *Clark,* 4 Ind. 316; *Minard* v. *Watts,* 186 Fed. 245; *In re Franklin Bank,* 1 Paige 249.

VII. That the case is ruled by its decision in *In re Interborough Consolidated Corp.*, 288 F. R. 334.

COMMENT: In fact, both the reasoning and the authorities cited in the *Interborough* opinion, 288 Fed. at p. 347 [9]—351 [18] are strongly in support of the Government's claim of an equitable lien.

But the case is not in point here, because of the great difference in the facts.

The Consolidated deposited about $432,000 in the Empire Trust Co. in an account entitled "Interborough Consolidated Corp. Interest on Interborough Metropolitan 4½% Bonds". It was the custom of the Consolidated, from time to time, shortly before coupons fell due on the bonds of an underlying mortgage of a constituent company [Metropolitan], to withdraw from its general funds sufficient money to meet the coupons and to deposit it in the above account at the Empire Trust Co. The Metropolitan mortgage provided that the interest should be payable at its New York office. As coupons were presented for payment at the Metropolitan's office [Consolidated office], the Consolidated drew a check on the Empire Trust Co. account for the amount of coupons presented; (the check stating on its face that it was to be paid out of the account above mentioned) and handed it to the person presenting the coupons, who cashed the check in the ordinary manner. Similar checks were mailed to registered holders.

The Consolidated went into bankruptcy with $432,000 on deposit. Coupon holders (who had not presented them for payment) sought to have

the fund applied exclusively to the payment of their past due coupons. The trustee in bankruptcy claimed it as general funds of the company.

The Court held that it belonged to the trustee. This was because (1) the Consolidated did not in any way create the Empire Trust as agent or trustee to apply the funds to the payment of coupons; (2) there was no sort of agreement between the Empire trust and/or Consolidated and the coupon holders that any such fund should be created or maintained or that the coupons should be paid therefrom; (3) the account was a purely voluntary one by the Consolidated, over which it retained complete control; (4) the Consolidated could have checked out all or any part thereof for its other uses—without in any way violating any duty or obligation to any one; (5) there was no need to have created the account, which was purely a matter of internal convenience for the Consolidated; (6) and there was no sort of trust imposed on the fund by agreement with anyone.

In the case at bar, by express agreement with the person furnishing the money, the contractor deposited it pursuant to a contract to use it for a specific purpose only, and the Banks accepted the deposit with knowledge of these terms.

The great difference between the two cases is, that, in the *Interborough* case, there was *no* contract between the Consolidated and the coupon holders that *this* fund should be applied to the coupons, nor between the Empire Trust and the coupon holders or the Empire Trust and the Consolidated that *any* fund should be maintained or regarding interest, whereas the Government expressly contracted with Butterworth-Judson Co.

that the fund should be kept separate and applied to a specific purpose, and the Banks took the deposit with knowledge of that contract.

So in *Staten Island Cricket Club* v. *Farmers L. & T. Co.*, 41 App. Div. 321, and *Noyes* v. *First Nat'l Bank*, 180 App. Div. 163, the deposit by a company of funds in a special account in bank, out of which the bank (at the company's request) paid coupons as presented, was held to be a general deposit for the company's use and did not impress any trust on the deposit. But in neither case was the deposit pursuant to any contract between the depositor and a third person (coupon holder or other person) that it should be devoted to that specific purpose and no other. The deposit was for the mere convenience of the company and the bank was merely the company's agent.

On the other hand, in *Rogers Locomotive Wks.* v. *Kelley*, 88 N. Y. 234, a company deposited money in a bank and took a receipt which recited that it was "in trust" to be applied to pay certain coupons and "said money not to be subject to the control of said company otherwise than for the payment of said coupons". It was held that it was a trust fund.

So too, in an earlier case of the *Interborough Consolidated Corp.*, 267 Fed. 914, it was held that where a consolidated corporation declared dividends and set aside in bank the money necessary to pay the dividends on so much of its stock as had not been delivered to stockholders of a constituent company, it became a trust fund for such stockholders, who when they presented their old stock in exchange for new stock were entitled to the accumulated dividends thereon.

CONCLUSION.

The decree should be reversed.

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VICTOR HOUSE,
Special Assistant to the Attorney General.

WM. MARSHALL BULLITT,
Of Counsel.

17 November, 1924.

No. 338

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924.

UNITED STATES,
Complainant-Appellant,

v.

BUTTERWORTH-JUDSON CORPORATION, *et al.*,
Defendants not appealing,

and

NATIONAL NEWARK & ESSEX BANKING COMPANY OF NEWARK, N. J., *et al.*,
Defendants-Appellees,

and

AMERICAN SURETY COMPANY OF NEW YORK, *et al.*,
Defendants-Appellants.

APPEAL FROM UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR APPELLEE, NATIONAL NEWARK & ESSEX BANKING COMPANY OF NEWARK, N. J.

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INDEX.

Cases Cited.

STATUTES CITED.

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Defendants-Appellees,
and
AMERICAN SURETY COMPANY OF NEW YORK, *et al.*,
Defendants-Appellants.

Appeal from United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR APPELLEE, NATIONAL NEWARK & ESSEX BANKING COMPANY OF NEWARK, N. J.

The defendant surety companies (Rec. p. 323) and the complainant, the United States of America (Rec. p. 327), have appealed to this Court from a decree of the United States Circuit Court of Appeals for the Second Circuit (Rec. p. 322) affirming a decree of the District Court of the United States for the Southern District of New York

(Rec. p. 266), dismissing the complaint as to the defendant banks and dismissing the counterclaims against the defendant banks contained in the answers of the defendant surety companies.

The counterclaim against the defendant banks contained in the answer of the defendant Butterworth-Judson Corporation was also dismissed, but *that defendant did not join in this appeal.*

The case was decided upon the preliminary motions to dismiss and the only facts before the court are the terms of the contracts between the Government and the Butterworth-Judson Corporation and the allegations of the pleadings.

The effect of the decree appealed from is to confirm the right of the defendant banks, as against the appellants, to set-off certain indebtedness of theirs to the defendant Butterworth-Judson Corporation totaling $519,631.99 (which arose from deposits made with these banks by said corporation) against larger debts owed by said corporation to the banks.

It is claimed by the appellants that the moneys so deposited by the Butterworth-Judson Corporation in the banks (a) were received by said corporation as a trustee for the Government, or (b) that the Government had some kind of an equitable lien thereon, and that the banks were charged with knowledge thereof and, therefore, had no legal right to set-off such deposits against debts owed to them by the Butterworth-Judson Corporation in its individual capacity.

The moneys in question were paid over by the Secretary of War to the Butterworth-Judson Corporation solely by virtue of the authority conferred upon him by the Deficiencies Appropriation Act of October 6, 1917 which authorized him to "advance payments" during the period of the

then existing emergency to contractors in amounts not exceeding 30% of the contract price of the supplies to be furnished and to fix the "terms" upon which such "advances" should be made and to require "adequate security" for the "payments" so made. (As to the extent of the authority conferred upon the Secretary of War by this statute, and his own interpretation of the words "terms" and "security" as used in the Statute, see *infra,* Point I.)

The contention of the appellee banks, which was accepted by the courts below, is that the contracts here involved did not create a trust or equitable lien in favor of the Government with respect to the moneys advanced, and that therefore the offsets made by the banks were proper.

The Surety Companies Are the Real Parties in Interest.

The real effect of the decree appealed from is to prevent the appellant surety companies from escaping their liability, to an amount equivalent to the total of the deposits offset by the defendant banks (*i. e.,* $519,631.99), as sureties in the bond for $750,000 given to the Government by the Butterworth-Judson Corporation to secure the performance by it of its contract with the Government (the Supplementary Agreement) under which the advances in question were made.

In the brief filed in behalf of the surety companies and of the Government it is sought to produce the impression that the decision of this case is of vast moment to the Government—that the fate of the "*customary* United States war time contract provision for advances to contractors"

(Appellants' Brief, p. 2) is at stake. There is nothing whatever in the record from which it may legitimately be inferred that there was any "customary" provision or that the interests of the United States under any other of its war time contracts with contractors will be adversely affected by the decision of this case.

Furthermore, it is evident that the affirmance of the decree appealed from will not cause the Government to lose a cent. Appellants' brief (p. 14) states that the balance concededly due the Government on account of the $1,500,000 advanced is only $611,450, and that this is a correct statement of the amount due is borne out by the allegations of the bill (fols. 83, 165-168; see also Statement of Account, Rec., p. 104).

This amount will be fully taken care of by the $750,000 surety company bond whenever the Government sees fit to call upon the surety companies to discharge their obligations. Moreover, the Government has a prior claim on the assets of the Butterworth-Judson Corporation by virtue of Section 3446 of the Revised Statutes which provides:

> "Whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied."

It is obvious, therefore, that the real appellants are the surety companies which are seeking to avoid the consequences of the risk which they were paid to assume, by shouldering off the larger part of their losses upon the defendant banks.

Furthermore, in this connection the prayer for relief (fol. 106) only asks that the complainant

have judgment against the defendant surety companies for such balance, if any, as may remain due to the Government after the banks have been compelled to pay over to the Government the amounts of the deposits offset by them and the receivers of the insolvent Butterworth-Judson Corporation have been required to apply all its remaining assets in satisfaction of the Government's prior claim.

The Questions Presented.

The Government's *bill of complaint* is based upon the theory that the moneys advanced by the Government to the Butterworth-Judson Corporation "*were a trust fund*" (fol. 75), and that, consequently, the deposits which were offset by the defendant banks "were in each instance *moneys belonging to the complainant*" (fol. 89).

This claim that the moneys advanced were a trust fund, moneys belonging to the complainant, has been entirely abandoned by the appellants in their brief on this appeal.

The only questions therefore, which are presented to this Court are:

1. **What were the powers of the Secretary of War under the Act of October 6, 1917?**
2. **Did the contracts, under which the advance of $1,500,000 was made, create any equitable relationship between the Government and the Butterworth-Judson Corporation so as to give the Government an equitable title to, or equitable lien upon, said advance payment?**

POINT I.

The power of the Secretary of War to make advance payments to war contractors was purely statutory and in derogation of the long established policy of the Government; and, as the statute did not expressly or by necessary implication empower him to impress a trust or equitable lien upon moneys advanced thereunder, he had no such power.

Prior to October 6, 1917, the Secretary of War had no authority to make, or to bind the Government by contract to make, advance payments to army contractors.

By the act of January 31, 1823, Ch. 9 (3 Stat. L. 723; R. S. §3648; 8 Fed. St. Ann., 2nd ed., p. 903), it was provided:

> "*No advance of public money shall be made in any case whatever.* And in all cases of contracts for the performance of any service, or the delivery of articles of any description, for the use of the United States, payment shall not exceed the value of the service rendered, or of the articles delivered previously to such payment. It shall, however, be lawful, under the special direction of the President, to make such advances to the disbursing officers of the Government as may be necessary to the faithful and prompt discharge of the respective duties, and to the fulfillment of the public engagements. The President may also direct such advances as he may deem necessary and proper, to persons in the military and naval service employed on distant stations, where the dis-

charge of the pay and emoluments to which they may be entitled cannot be regularly effected."

In 1862 the Attorney-General rendered an opinion that

> "It is the plain meaning of this law that no money shall be advanced to contractors; that is, that no money shall be paid to them on account of their contracts before the actual performance of the service or the delivery of the articles stipulated for. And this not only forbids the contracting officer of the Government to pay the money in advance but *forbids him also to contract for such payment.*"
>
> 10 Op. Atty.-Gen. 288.

Statute Authorizing Advance Payments.

Prior to 1917 Congress had from time to time made various specific exceptions to the general rule established by that act, but none which is material here, and the only authority conferred upon the Secretary of War to contract for or make the prepayments involved in this suit is found in section 5 of the Deficiencies Appropriation Act of Oct. 6, 1917 (Fed. St. Ann., Supp. 1918, p. 671), the full text of which is as follows:

> **"That the Secretary of War and the Secretary of the Navy are authorized, during the period of the existing emergency, from appropriations available therefor to advance payments to contractors for supplies for their respective departments in amounts not exceeding thirty per centum of the contract price of such supplies: Provided, That such advances shall be made upon such terms as**

the Secretary of War and the Secretary of the Navy, respectively, shall prescribe and they shall require adequate security for the protection of the Government for the payments so made."

As was stated in the opinion below (Rec. 313), that statute

> "used simple words of well defined meaning in the law and, for that matter in everyday commercial relations. It seems almost elementary to state that 'advance payments' means payments in advance for things purchased and thereafter to be delivered. 'Advance payments' to contractors for supplies can mean nothing else than that the Secretary of War or the Secretary of the Navy, as the case might be, was authorized to arrange with contractors for supplies and within the statutory limit to pay these contractors in advance for these supplies."

Congressional Purpose.

The purpose which Congress had in view is shown by the following statement of Commander C. A. Kearney, Acting Chief of Ordnance and Ordnance Stores, July 25, 1917, at hearings before the sub-committee of the House Committee on Appropriations in charge of deficiency appropriations on account of war expenses (Hearings, pp. 242-3.)

> "The CHAIRMAN. What is this item you have about advance payments?
>
> Commander KEARNEY. Under date of June 5 we wrote the Secretary of the Navy, and I think at a subsequent date he wrote to Congress, recommending that one of two things

be done. First, that inasmuch as the Secretary of the Treasury has authority to deposit Government funds with various banking institutions at a normal rate of interest and that these same institutions make a practice of loaning money on approved security, the idea was to ascertain whether the Treasury could possibly permit the loaning of money at a nominal rate of interest, using the contracts as a security. This was found to be illegal, so that dropped of its own accord. The other suggestion was that Congress be asked to pass a resolution similar to the following:

> RESOLVED, That during the period of the present War the executive departments of the Government be, and are hereby authorized to make *an advance payment* to contractors for supplies, as may be necessary, in an amount not to exceed 30 per centum of the contract price of the articles, in order that the contractor may prepare promptly and without distress for the work, provided that such contractor will give an acceptable surety to the Government for the money so advanced.

We have either actually made or are negotiating contracts with a number of new firms; that is, firms that have never before undertaken Government ordnance work for the Navy.

Mr. GILLETT. When you say new firms, you mean new as to Government work?

Commander KEARNEY. Yes.

Mr. GILLETT. But they are all old firms?

Commander KEARNEY. Yes.

Mr. GILLETT. They are not new firms organized to go into the business of manufacturing for the Government?

Commander KEARNEY. No; they are old firms who are about to take on a new activity. These firms, while they could go out and borrow the money, would have to figure in their estimate to us, for a manufacturing price, the cost of that interest, otherwise they would lose; and *we felt that if we could obtain an authorization from Congress to advance approximately 30 per cent with approved surety these concerns could go ahead with the work, and we have their assurance that this could be done.*

Mr. GILLETT. If you want authority to do that for one concern, you would have to do it as to all?

Commander KEARNEY. Yes, sir; and that is the reason why it provides for contracts already placed; all would be placed in the same position of receiving an advance of 30 per cent.

Mr. SHERLEY. You would have to pay it to all concerns that were not previously equipped for Government work?

Commander KEARNEY. Yes.

Mr. SHERLEY. But you would not make *advance payments* to concerns that have going plants capable of doing Government work?

Commander KEARNEY. No; the advancements would be made only after a thorough investigation of the demands of the company, verified by our own inspectors and our own officers—our accounting officers.

On September 14, 1917, Mr. Fitzgerald, Chairman of the House Committee on Appropriations, stated on the floor of the House with reference to the proposed statute:

> "There is a recommendation that the Navy Department and the War Department at the present time be authorized *to advance 30% on contracts before materials are delivered*, upon adequate security being taken. That is to enable the Government to aid in financing plants that otherwise could not carry on the work that it is essential should be done for the benefit of the Government" (Congr. Rec., Sept. 14, 1917, p. 7142).

Interpretation of Act by Secretary of War.

The interpretation of the statute by the Secretary of War is shown by his instructions to the War Credits Board, issued April 22, 1918, relative to advance payments to contractors for supplies under the Act of October 6, 1917:

WAR DEPARTMENT

Washington, April 22, 1918.

From: The Secretary of War.
To: War Credits Board.
Subject: Duties of the Board.

1. Authority to advance payments to contractors for supplies is devolved upon The Secretary of War by Section 5 of Public Act 64, Sixty-fifth Congress, approved October 6, 1917, in the following language, viz.:

> "That the Secretary of War and the Secretary of the Navy are authorized, during the period of the existing emergency,

from appropriations available therefor to advance payments to contractors for supplies for their respective departments in amounts not exceeding thirty per centum of the contract price of such supplies: *Provided*, That such advances shall be made upon such terms as the Secretary of War and the Secretary of the Navy, respectively, shall prescribe and they shall require adequate security for the protection of the Government for the payments so made."

2. The Secretary of War has constituted a Board, with authority as stated below, to be known as the War Credits Board; and has appointed three officers to be the members thereof. The Board will appoint an Executive Secretary who may act in the place of any absent member; and may appoint a Deputy Executive Secretary with like duties and powers; will have detailed to it a suitable staff of officers of technical and professional attainments; will employ financial examiners, accountants, statisticians and engineers; will be allotted an appropriate force of clerks, stenographers and messengers, and will be furnished suitable quarters.

3. The said Board is ordered to hear and determine applications for advances of money to contractors, and in my name to instruct the appropriate contracting and financial representatives of the War Department to make and to contract to make advance payments by authority of the said Act, under the following rules and restrictions, which have reference especially to the language of the Act following the word "Provided."

I. *Security.*

The Board will carefully investigate the security offered for the advances, and will see to it that the same be adequate for the protection of the Government.

The language of the Act, in respect of the adequacy of the security, contemplates that the Government shall be adequately protected by the aggregate of (a), the direct financial responsibility of the contractor, and (b), the additional security required to be taken. The extent to which such security is required, therefore, varies inversely with the direct financial strength of the contractor; and it follows, that advances to responsible contractors will be adequately secured by a relatively small amount of additional security.

As to the form of security. The Board may accept as security the following:

(a) Obligations or guarantees of responsible individuals or corporations—as, notes or endorsements on notes; bonds, single or conditional; or other contractural guarantees.

(b) Stocks, bonds, receiver's certificates, certificates of deposit, warehouse receipts and other negotiable muniments of title; properly endorsed for transfer.

(c) Mortgages, trust deeds, assignments or other instruments conveying title to property. Conveyances of property should vest such property in the Secretary of War or in an Assistant Secretary, or his nominee, as trustee with authority to reconvey.

(d) Other equivalent security. In general, in respect of the form that equivalent security may take, the Board is instructed that:

(e) The Government is a preferred creditor in bankruptcy and therefore, if the contractor be prohibited from alienating or encumbering his property to others than the Government, such prohibition may be substantially equivalent to encumbrance or alienation in the Government's favor.

(f) Similar considerations govern advances made under such conditions and restrictions

that the funds advanced are definitely procured to be held in trust until paid out under the contract, for property to which the Government holds or automatically acquires title, or in meeting expenses incurred in the direct performance of the contract for supplies.

II. *Terms.*

(a) Recoupment of advances, by the Government. Recoupment shall be provided for, by original or supplemental contracts, in such manner that the money advanced may be returned by delivery of its equivalent in supplies under the contract during the life thereof.

(b) Interest. The Board will require interest to be paid on the outstanding balances of all advances, payable in supplies; but the Board may waive interest in cases where in its opinion the Government will obtain the equivalent thereof in another form. When interest is required it will be charged at rates to be determined by the Board responsively to financial conditions.

(c) Consultation with other Government officials, respecting terms, etc. The Board is authorized to inform the Treasury of prospective withdrawals of funds advanced to contractors and to consult with representatives of the Treasury regarding financial conditions, interest rates, issuance of capital securities of contractors for supplies, etc.; and to advise War Department contracting officers respecting the financial responsibility of contractors or prospective contractors.

III. *Inspection and custody of instruments or evidence of security.*

(a) Inspection. All instruments or other evidences of security furnished by the contractor will be delivered through contracting or financial officers of the supply bureau to the Board for its inspection and approval.

(b) Custody. All valuable securities or instruments upon which advances shall be made under the Board's approval will be delivered to the Board or to a responsible trustee designated by it, for custody and safekeeping; and the Board will receipt for such securities and documents or the certificates of deposit of such trustee therefor, and will cause them to be deposited in a secure place provided by the War Department pending return to the equitable owners thereof.

(c) Substitutions, etc. Substitution of securities and similar transactions customary in the business world will be permitted under proper regulations and safeguards.

(d) The Board may from time to time call on financial officers of the War Department for reports and statements of account showing the status of advances and the recoupment thereof; and in cases of impaired credit or doubtful recoupment will transmit the papers and evidences of security in the case to the Judge Advocate General of the Army with recommendation that he take such legal action as may to him seem appropriate in the premises.

IV. *Special instances.*

In cases of unusual difficulty or exceptional magnitude the Board will present its recommendation to the consideration of The Secretary of War, or the Assistant Secretary.

4. Copies are attached hereto of letters of even date respectively

(a) confirming appointment of the members of the Board and

(b) instructing purchasing, contracting and financial officers and representatives of the several supply bureaus respecting their duties concerning advance payments to contractors for supplies.

NEWTON D. BAKER,
Secretary of War.

In the above instructions, the Secretary of War clearly recognized that the relation which the statute authorized him to establish between the contractor and the Government was merely that of debtor and creditor; that the "*Security*" which he was required to take was the ordinary class of collateral, plus the responsibility of the contractor; and that the "*Terms*" which he was authorized to fix related to such matters as "recoupment" or repayment by deliveries of supplies, rates of interest, etc. *There is nothing whatever in these instructions to indicate that the Secretary construed the act as authorizing him to impress an equitable lien upon the advance itself.*

It should be noted that appellants' brief (Page 23), quoting only a part of Par. I (f) of this order of the War Department, gives the impression that moneys advanced were to be held in trust. This is clearly erroneous.

A reading of the full text of Par. I, (f), under "Security", discloses the fact that in the event moneys advanced are to be held *in trust* until paid out under the contract, similar considerations with respect to security shall govern. In this case, no trustee was named and no trust was created, and therefore this paragraph has no bearing upon the construction of the contract in question.

The only object of the statute was to enable the Secretary of War and the Secretary of the Navy to make partial payments in advance for supplies contracted for. The statutory authority was simple, clear and free from ambiguity. It was merely "*to advance payments to contractors*" subject to the duty to fix the terms upon which the advances were to be made, *i. e.*, time and manner of repayment, interest rates, etc., and to require "ade-

quate security'' to insure that the Government would either get the supplies so paid for in advance or else recover back the amount advanced.

As between the contractor and the Government it was the obvious intent of Congress that the only relation which might lawfully be created in making the advances of public money authorized by the statute was that of *debtor and creditor.* The Secretary of War was given no authority to establish any relation between them which might involve the Government in the commitments or liabilities of the contractor and, if he had attempted to do so, his acts would have had no binding force.

The authority of the Secretary of War arising from this statute is limited to its specific terms.

In *U. S.* v. *Alexander,* 110 U. S. 325, the Government sued on a distillery warehouse bond. It appeared that the Secretary of the Treasury had abated the taxes to secure which the bond was given but had subsequently revoked the order of abatement. It was held that the abatement of the taxes operated to cancel the bond and that, as the Secretary of the Treasury had no statutory authority to revoke the abatement or to restore the obligation of the bond, the Government could not recover thereon. At page 329 the Court said:

> ''In the case of *The Floyd Acceptances,* 7 Wall. 666, it was held by this court that, under our system of government, the powers and duties of all its officers are limited and defined either by statutory or constitutional law. Applying this rule to the present case, we are unable to find in the statute any authority for the action of the Secretary of the Treasury in revoking the abatement of taxes once made by him, and must conclude that the authority does not exist. He might re-assess the tax, but the bond given for the tax which had been abated would not be security for the re-assessed tax.''

It has been consistently held by this Court in a long line of decisions that the United States itself is neither bound nor estopped by acts of its officers or agents in entering into an arrangement or agreement to do or cause to be done what the law does not sanction or permit.

Yuma Water Assoc. *v.* Schlecht, 262 U. S. 138, 144;
Utah Power & Light Co. *v.* U. S., 243 U. S. 389, 409;
Parr Run Logging Co. *v.* U. S., 186 U. S. 279, 291;
Hart *v.* U. S., 95 U. S. 316;
Whiteside *v.* U. S., 93 U. S. 247;
Filor *v.* U. S., 9 Wall. 45, 49;
The Floyd Acceptances, 7 Wall. 666;
Lee *v.* Munroe, 7 Cranch 366.

CONCLUSION.

We have shown:

(1) That for more than a century it has been the settled general policy of the Government that "no advance of public money shall be made in any case whatever."

(2) That the Act of Oct. 6, 1917, departed from that policy only to the extent of authorizing "advance payments to contractors for supplies" up to 30% of the contract price thereof during the period of the war emergency.

(3) That in the Congressional discussions preceding the enactment of that statute there was no indication of any purpose to create between the Government and the contractor, or between the Government and any third person into whose hands the moneys advanced might come, any sort

of fiduciary relationship with respect to those moneys; but that, on the contrary, the manifest intent was that the Government should look for its protection to an acceptable surety or to other collateral security.

(4) That the statute itself directed the Secretary of War to "require adequate security for the protection of the Government for the *payments so made*," thereby clearly indicating that the advances were to be "payments" pure and simple and that the term "adequate security" meant security in the ordinary sense of collateral and was not intended to give the Secretary power to retain any sort of equitable hold upon the advances themselves as security for their repayment.

(5) That the Secretary of War himself, in his instructions to the War Credits Board, did not interpret the statute as giving him power to create an equitable lien upon moneys advanced thereunder, and his reference in paragraph I (f) to the holding of money "in trust until paid out under the contract" manifestly contemplated only a trust with an independent trustee who was to pay the money over to the contractor, in which case "similar considerations" as to security were to govern. (See opinion below, Rec. p. 320.)

In view of the above, we contend that the statute conferred upon the Secretary of War no power to create either a trust in, or an equitable lien upon, moneys advanced to a contractor and paid over to him.

We shall now proceed to show that in the contracts here involved there is no evidence of an intention to exercise such a power.

POINT II.

The terms of the contracts did not indicate an intent to create in favor of the Government an equitable title to, or equitable lien upon, the moneys advanced, and consequently the banks were not put on notice of the existence of such a title or lien by knowledge of the terms of the contracts.

We concede that, if the Secretary of War had the power and if it was his intention to create in favor of the Government, by way of security, an equitable title to, or equitable lien upon, the moneys advanced; and if that intent was clearly expressed by the terms of the contracts so as to give notice of the existence of such title or lien to a third person reading the contracts;—then the banks were not lawfully entitled to the set-offs.

On the other hand, we contend that, unless such an intention is clearly disclosed by the terms of the contracts, considered as a whole, the decree appealed from was right and should be affirmed.

The courts will not *infer* such an intention or read it into the agreement.

The theory pleaded in the bill, that the contracts made the advances "a trust fund" in the hands of the Butterworth-Judson Corporation, has been abandoned on this appeal and the contentions of the appellants have narrowed down to the theory that the money was received by that corporation subject to an equitable lien in favor of the Government and that the depository banks were put on notice of that fact by the terms of the contract.

In order to charge third persons with notice of the existence of an equitable lien, there must be a clearly expressed intent to pledge designated property as security.

In 25 Cyc. 665, it is said:

> "As a general rule every express executory agreement which is in writing, based upon a valuable and adequate consideration, whereby a person *clearly indicates an intention* to make or appropriate, *as security* for a debt or other obligation, some particular property, real or personal, or fund therein described or identified, or whereby the party promises to assign or transfer the property *as security*, creates an equitable lien upon the property so indicated."

In re Interborough Consol. Corp., 288 Fed. 334 (certiorari denied 262 U. S. 752), decided by the Circuit Court of Appeals for the Second Circuit, a corporation made deposits *in a special account* which were accepted by the depositary with knowledge that they were made for the special purpose of paying interest coupons. The corporation becoming bankrupt the question arose as to whether the balance remaining in this special account passed to the trustee in bankruptcy as part of the general assets or was subject to a trust or equitable lien or other equitable claim in favor of the holders of coupons. In that case as here, it was first claimed that there was a trust relation and later the theory was advanced that an equitable lien existed. The court said at pages 348-9:

> "But the argument by which it is sought to establish an equitable lien seems to us as

untenable as that by which it was sought to show, on behalf of the original petitioner, the existence of a trust. An equitable lien is neither a *jus in re* nor a *jus ad rem*. It is not a property in the thing itself, nor does it constitute a right of action for the thing, but is simply a charge upon it, and, as was remarked by Erle, J., in *Brunsdon* v. *Allard*, 2 El. & El. 19, 'the words equitable lien are intensely undefined.' The doctrine of equitable liens has been liberally extended in modern times to facilitate mercantile transactions. *But it has been done to give effect to the intention of the parties to create specific charges and that that intention might be justly and effectually carried out.* **But the courts are not authorized to find the intention when none existed.''**

In order to find an intention to create an equitable lien there must be either (1) an agreement between the parties that a specified fund or other property shall be held *as security* for the obligation; or (2) a definite limitation of the obligation to payment out of a specified fund.

In all of the cases in which *this Court* has held that there was an equitable lien the decision has been based squarely on the existence of one or the other of those facts.

In the following cases cited by appellants it was expressly agreed that the bonds or other property in question should be held *''as security''* for the obligation, and it does not appear that there was any other security therefor.

Sexton *v.* Kessler, 225 U. S. 90;
Walker *v.* Brown, 165 U. S. 654;
Hauselt v. Harrison, 105 U. S. 401.

In the following cases cited by the appellants the obligation was definitely limited to payment out of a specified fund.

Ingersoll *v.* Coram, 211 U. S. 335;
Barnes *v.* Alexander, 232 U. S. 117;
Valdes v. Larrinaga, 233 U. S. 705.

In *Christmas* v. *Russell,* 14 Wall. 69, and *Fourth Street Bank* v. *Yardley,* 165 U. S. 634, which are also cited by the appellants, the principles discussed were those relating to equitable *assignments,* and those decisions have no real bearing on the present situation.

An examination of the facts in all of the cases in *other courts,* cited by the appellants, shows that those courts applied the same principle in either allowing or rejecting the claim of equitable lien.

In each case it is found that the party asserting the lien originally looked to a specific thing or fund *as security* for the debt sought to be collected, and in practically every case this was the only security.

In the case now before this Court the Government specified its security definitely, and was and is amply protected by that security—the note and the surety bond.

The special accounts into which the advance payment was to be placed are not mentioned as security. The right of the Butterworth-Judson Corporation to use them, and completely exhaust them, negatives any intention to create additional security.

The fact that the Government would always be a preferred creditor in case of insolvency negatives any necessity for additional security.

The following brief extracts from cases cited in appellants' brief show that the Courts have uniformly recognized this principle in their decisions.

In *Sexton* v. *Kessler*, 225 U. S. 90, the appellee was an English company and the bankrupts a New York firm which had drawn upon it for many years. The English house requested them to set aside securities for their drawing credit, suggesting a form of security which read, "We certify that we have specially set aside and hold for your account on this the 31st day of December, 1903, *as security for the drawing credit* which you accord to us the following securities." This was conformed to.

The Court said of the security or "escrow":

> "It was confined to specific identified stocks and bonds on hand, and purported to give an absolute personal right qualified only by possible substitution."

In *Barnes* v. *Alexander*, 232 U. S. 117, the Court construed the following agreement:

> "If you will attend to this case I will give you one-third of the fee which I have coming to me on a contingent fee from Shattuck, Hanninger & Marks."
>
> The Court said: "The obligation of Barnes was as definitely limited to payment out of the fund as if the limitation had been stated in words, and therefore creates a lien upon the principle not only of *Wylie* v. *Coxe, supra*, but of *Ingersoll* v. *Coram.*"

In *Hauselt* v. *Harrison*, 105 U. S. 401, Hauselt agreed to advance money to Bayer to buy skins and tan them in his tannery. Hauselt was to sell

them for a commission and take out the amount of his advances with interest. It was agreed "that all the skins * * * shall be considered *as security* for the refunding, with interest, of all the moneys advanced by the party of the second part" (Hauselt).

> The Court said: "We cannot agree * * * that the only security given to Hauselt by the contract was the personal promise of Bayer that he would perform it. To limit the contract to that extent is to deprive its last provision of all force; for, without it, the personal obligation to deliver the skins when tanned would still remain. The clause providing *for security* must be held to mean something; and it declares that the skins themselves, before delivery of possession to Hauselt under the contract, for purposes of sale, *shall be considered as security.*"

In *Walker* v. *Brown,* 165 U. S. 654, the Court construed the following:

> "I beg to advise you that the loan of $15,000, Memphis bonds, made by me for the use of Messrs. Lloyd & Co., Ellensburg, is with the understanding that any indebtedness that may be owing to you at any time, shall be paid before the return to me of these bonds or the value thereof * * *."
>
> The Court said: "This language certainly designates the bonds or the value thereof *as a security* for the debt to Walker & Co."

In *Ingersoll* v. *Coram,* 211 U. S. 335, Ingersoll having asked for some assurance that he would be paid for his services, received the following agreement:

> "We agree that for your services in the contest of Maria Cummings * * * against

> the probate of the alleged will of A. J. Davis, deceased * * * that your fee in case the will is defeated * * * shall be $100,000 * * *. There is to be no personal obligation against J. A. Coram in the event that the interests represented by Henry A. Root are unsuccessful, and in no event is the said J. A. Coram obligated except to pay such fee out of the funds secured from the estate of A. J. Davis, deceased, to Maria Cummings * * *.
>
> (Signed) HENRY A. ROOT
> J. A. CORAM."

The Court said: "It is evident, therefore, that Ingersoll asks *for security* in a definite and written form. We do not think it can be said that he sought only a promise to pay. That followed from his employment, and besides Coram stipulated against personal liability, but did obligate himself to pay 'out of the funds secured from the estate', and this is the test of the agreement. It is the exception that establishes that as to Root there was a personal and property obligation; as to Coram a property obligation."

This Court in reviewing the authorities said: "In *Walker* v. *Brown* * * *, it was held that every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, or fund, therein described or identified, *a security* for a debt or other obligation, *creates an equitable lien* on the property so indicated."

In *Fourth Street Bank* vs. *Yardley*, 165 U. S. 634, the Keystone Bank asked the Fourth Street Bank to give it $25,000 of gold certificates for which it gave the Fourth Street Bank its check against its reserve account in the Tradesmen's

Bank in New York. The gold certificates were delivered and the check issued to the Fourth Street Bank. When the draft, however, was presented in New York payment was refused. The Court held that the evident intent of the parties was that the gold certificates should be given to the Keystone Bank on condition that it assign to the Fourth Street Bank its interest in its reserve account in the Tradesmen's bank. The Court said:

> "It is impossible to infer otherwise than that it was intended that the particular fund in the Tradesmen's Bank should be not only the source from which payment of the check to be given should be made, but that the fund should be transferred and appropriated *pro tanto* for that purpose. * * * The authorities are clear that when it is established that it was *the intention and agreement* of the parties to a transaction that a check drawn generally should be paid *out of a particular fund,* such check, as between the parties, will be treated as though an order for payment out of a specific designated fund."

This was a case of an equitable assignment, and there was no other security in the case than this account of the Keystone Bank in the Tradesmen's Bank.

In *Valdes* v. *Larrinaga,* 233 U. S. 705, Valdes wrote Larrinaga that he had applied for a water franchise to develop electric power, saying, "I propose to interest you in the profits of said concession in the amount of 10%, provided that you accept the obligations hereinabove mentioned." To this Larrinaga answered, "I hereby accept the participation of 10% of said concession in exchange of my personal or professional services

without any obligation on my part to contribute money to the exploitation."

In this case there was a designated fund out of which alone payment was to be made. Also the case involved a partnership and has no application to the facts of our case.

In *Legard* v. *Hodges*, 1 Ves. Jr. 478, a case decided in 1792, it was held that a covenant to pay to a third party one-third of the annual profits of land creates in equity a lien on land against the covenantor and claimants under him with notice. It was held that it was a pure trust estate and that the trustees were the trustees of one-third of the clear annual profits. This was a genuine trust with a trustee, a trust fund and cestuis, and is therefore clearly distinguishable from the case at bar.

In *Dodsley* v. *Vasley*, 12 Ad. & E. 632, the defendant bought wool of the plaintiff and took it to the premises of Danley where defendant usually received wool delivered to him. The wool in question had not been paid for, but had been placed in defendant's bags ready for delivery. It was held that the plaintiff had a special interest in the goods until he was paid. This case involved only the interest of an unpaid vendor in goods which had been taken possession of by the buyer without payment, and has no application to the case at bar.

In *Curtis* v. *Walpole Tire & Rubber Co.*, 218 Fed. 145, the Tire Company being indebted to Anthony gave him a note for $15,000 and as security gave him a letter to the Foster Rubber Company, directing them to pay to Anthony the $15,000 they owed to the Tire Company.

The Court said:

> "The Tire Company retained no right to collect the account for its own benefit or to revoke the disposition promised as to the future. By the assignment an equitable interest in the account as it then stood and as it might thereafter accrue, passed to the claimant *as security* for his note, together with a power to collect the account and apply the proceeds in satisfaction of the note."

This was a case of an equitable *assignment*, the debtor retaining no control over the obligation assigned. In our case the contractor has never assigned nor attempted to assign any of its bank deposits to the Government.

Discussion of Contracts.

No intent to create an equitable lien is disclosed.

The issues in this case center about the supplemental agreement dated May 22, 1918 (Exhibit B, Rec., p. 61). The title of this contract is "Supplementary Agreement Between Butterworth-Judson Corporation Contractor and United States of America Covering Advance Payment to Contractor". Immediately following the execution and delivery of this contract, the Government advanced and paid by check to Butterworth-Judson Corporation $1,500,000.

Immediately upon such advance the title thereto passed to Butterworth-Judson Corporation, and a debit and credit relation was established, (App. Brief, p. 21), under which Butterworth-Judson Corporation was bound to repay the moneys so received, either (a) by delivery of picric acid at

prices agreed upon, or (b) by payment of the debt, or any balance of the debt, with interest, at any time.

Appellants' main contention is that, by reason of the clause in the contract calling for a deposit by Butterworth-Judson Corporation of $1,500,000 in special accounts in banks, separate from its other funds, some sort of a relation between the Government and Butterworth-Judson Corporation was developed in the nature of a trust or equitable lien which gave the Government a grasp on the moneys so deposited of such a character that a bank having notice of the Supplementary Agreement could not exercise its legal right of set-off against such bank balances.

The correctness of this contention of the appellants must be determined by a careful analysis and construction of all of the terms of both agreements as bearing upon the intention of the parties.

It should first be noted that in the form in which this case comes before the Court it must be assumed that all the banks parties hereto had notice of both agreements, and therefore of all of their terms. But it must also be observed that the banks which made the "unsecured" loans are entitled to rely upon the same reasonable construction of the terms of these agreements which this Court must apply as a matter of law.

PRINCIPAL AGREEMENT.

On May 9, 1918, the United States of America entered into the principal contract with Butterworth-Judson Corporation (Exhibit A, Rec. p. 38), calling for the selection and purchase of a site for a picric acid plant, construction of a plant

at an estimated cost of $7,000,000, and operation of such a plant when constructed until it had produced 72,000,000 pounds of picric acid, which was to be purchased at a price of 53¢ per pound ($38,160,000).

This contract also provided for an advance payment by the Government of $1,500,000 within ten days, failing which the contractor had a right to terminate the contract; and further provided that if the War Credits Board required the contractor to pay interest on the advance payment, the United States should allow the contractor to include the said interest as a part of the cost and expenses under the contract.

The relation between the parties as to the whole operation, with respect to financial needs, divides itself into three parts:—

1st: The site was to be selected by Butterworth-Judson Corporation, approved by the Government, paid for by Butterworth-Judson Corporation and upon delivery of title deeds, the Government was to pay to Butterworth-Judson Corporation the cost of the site, procuring the site, title examinations, etc. (Article II, Principal Agreement, Rec. fols. 118-120). This transaction was completed.

2nd: Butterworth-Judson Corporation was to prepare plans for a complete plant, to construct, equip and pay for the same, and upon proof of expenditures so made the Government was to reimburse the Butterworth-Judson Corporation for such expenditures (Article III, Principal Agreement, Rec. fols. 120-127). Title to the plant and materials was to vest in the United States simultaneously with payment as made. There was,

therefore, full protection to the Government for all payments made for plant construction, since it obtained title thereto.

3rd: An *advance payment* of $1,500,000 was to be made against the purchase of the supplies, consisting of picric acid contracted for (Article XVI, Principal Agreement, Rec. fol. 150).

This advance payment against supplies purchased under the principal contract was covered by the terms of the supplementary agreement of May 22, 1918.

SUPPLEMENTARY AGREEMENT.

1. The title of this contract indicates its object and purpose—"Butterworth-Judson Corporation, Contractor, and United States of America, Covering Advance Payment to Contractor" (Rec. p. 61).

The Debt.

2. Article II (fol. 185) provides that "the Government shall advance to the contractor under the Principal Agreement an amount not exceeding the sum of One Million, Five Hundred Thousand Dollars ($1,500,000), on the terms and security hereinafter mentioned, and shall make payment by check directly to the contractor."

Under this Article, the Government parted with title to the money, and a debit and credit relation between the two parties was established.

The Repayment.

3. The contractor could account for or repay the money so advanced in two ways (Article III): (a) "by applying and crediting the *said advance with interest* to the payment of vouchers presented by the contractor to the Government, covering deliveries of picric acid under the Principal

Agreement" (Rec. fol. 185), or (b) by at any time repaying "to the Government in cash, the entire outstanding balance of *said advance with interest* due thereon" (Rec. fol. 188).

The obligation of the contractor was to pay the advance *with interest.* If the repayment had been made by delivery of picric acid, it is quite true the contractor would have received credit for interest as a part of the cost of manufacture. Interest is uniformly regarded as part of the cost of manufacture where money has to be borrowed, but this does not effect the obligation to pay interest. However, in this case the contract was cancelled before the plant was completed and manufacturing begun. Hence, no interest credit could arise. *This entirely disposes of the somewhat confused contention on the question of interest made in appellants' brief* (p. 69).

4. Article III further provides (Rec. fol. 189): "If under the foregoing provisions the Government does not recoup [this word taken from War Department Instructions, ante, p. 14] the total amount of the advance with any interest due, or if the contractor shall not furnish to the Government the supplies in whole, or any part thereof, as provided in the Principal Agreement, even though the Government shall for any reason terminate said Principal Agreement, the contractor shall return to the Government, on demand, any *balance of the said advance and interest* after deducting the total of any recoupments made as hereinabove provided, together with all liquidated accounts that may be due and owing under the Principal Agreement from the Government to the contractor."

This clause provides for the very contingency which happened, namely, the cancellation of the contract, and determines exactly what Butterworth-Judson Corporation should repay to the

Government, namely, *the balance of the advance and interest*, less previous payments and liquidated accounts due and owing.

Appellants' Brief (page 20) specifically states: "The contractor was to return to the Government any unexpended balance *in the special accounts* after deducting any sums the Government owed the contractor."

This statement of the terms of the contract is absolutely incorrect. There was no provision for a return or repayment of "any unexpended balance in the special accounts." Article III reads that upon cancellation of the contract "The contractor shall return to the Government, on demand, *any balance of the said advance and interest.*"

This Article clearly recognizes the debt, the credits to be allowed, and the repayment of the balance *of the debt*, and in no way suggests or intimates that the Government asserted any claim or lien upon the deposit balances "in the special accounts".

The Security for the Debt.

5. After stating the debt and the terms of repayment the contract proceeds to describe the security to be given, and specifies as follows (Art. IV, Rec. fols. 190-192): "As collateral security for the recoupment or return of the above mentioned *advance, and any interest* due, the contractor shall furnish to the Government, on the signing of this agreement: *a.* The demand note of the contractor for One Million, Five Hundred Thousand Dollars ($1,500,000), of even date herewith *bearing interest* at the rate of

six per cent per annum and payable to the order of the Secretary of War, on behalf of the United States at his office, Washington, D. C. *b.* A bond in the sum of Seven Hundred Fifty Thousand Dollars ($750,000), and in form and with surety as may be approved by the War Credits Board and the contracting officer and conditioned on the performance by the contractor of its obligations under this agreement."

There is no mention whatever of the bank balances created by the deposit of the $1,500,000, although it would have been the natural thing for the Government to have made such mention, had it intended to make such deposit balances security for its debt. The only security referred to is the note of a responsible contractor and the bond of a responsible surety.

Enforcement of Security.

6. As to the enforcement of its security, the contract provides (Rec. fols. 191-192) that "On the failure of the contractor, *at any time*, to comply with the terms of this agreement, the Government may sell the said demand note at public or private sale, or otherwise, and with or without notice to the contractor, applying the proceeds after payment of the costs of sale towards the repayment of the above mentioned *advance, and interest due thereon*, and accounting to the contractor for the balance, if any."

This is the only provision with respect to what the Government should do with its security in the event of default. The absence of any mention of the bank deposits in this paragraph also indicates a clear intention on the part of the Government not to look to such bank deposits as security.

Special Accounts.

7. We now come to the provision of the contract requiring the contractor to deposit the moneys advanced in special accounts, about which centers practically the entire contention of the appellants.

Article VI (Rec. fol. 192) provides as follows:

> "The contractor shall deposit the money advanced hereunder in special accounts in banks, separate from its other funds, and shall draw on said accounts only in payment of [1] expenditures made and obligations incurred in designing, constructing and equipping the plant specified in the Principal Agreement, and for other equipment, and [2] for material, labor and overhead expense, required in the direct performance of the Principal Agreement, unless otherwise authorized in writing by the War Credits Board." (Bracketed figures ours.)

It should be noted that the contractor here had full authority to draw on this account of $1,500,000 not only for material, labor and overhead expense, which was a part of the cost of picric acid sold, but also for the construction of the plant, the estimated expense of which was $7,000,000. It is, therefore, clear that payments for the construction of the plant must have exceeded the full $1,500,000 several times over, and except for reimbursements there would have been no balance in these special accounts. In the ordinary course of business these special accounts would have been entirely exhausted.

This fact is particularly important as bearing upon the next paragraph of the Article, which reads as follows:

> "The contracting officer **may** require that the contractor shall deposit in said accounts funds paid by the Government to the contractor reimbursing the contractor for expenditures made from this advance in designing, constructing and equipping the plant, as provided in Article VI of said contract between the parties hereto, dated May 9, 1918" (Rec. fol. 194).

If the Government intended to hold the $1,500,000, or any part of it, deposited in the special accounts as *security for its debt*, it certainly would not have given the discretion to a contracting officer to decide whether or not after moneys had once been drawn out of these accounts reimbursements should be redeposited therein.

The use of the word "may" instead of "shall" would seem to negative any intent on the part of the Government to attempt by this Article VI to create an equitable lien on these special accounts, since the failure of the contracting officer to require the deposit of reimbursements would have destroyed the entire fund upon which such an equitable lien might attach.

The only reasonable explanation for the Government desiring to have the $1,500,000 which it advanced deposited in special accounts separate from its other funds and drawn on only in payment of expenditures in the construction and operation of the plant to be erected, is that the Government desired to simplify the checking of accounts between itself and the contractor, which would be much more complicated were these moneys mixed with the other funds of the Corporation. In no sense does the presence of this provision destroy the debit and credit relation or re-

quire a construction of the entire contract as giving to the Government additional security for its debt in the form of an equitable lien upon the deposit balances in these special accounts.

The Surety Bond.

As bearing further upon the question whether the parties intended to create an equitable lien upon the $1,500,000 deposited in special accounts in banks, we would call attention to the surety bond given as part collateral security for the repayment of the advance payment.

The Surety Companies, which are the real parties in interest on this appeal, gave their surety bond under date of May 22, 1918, in the sum of $750,000 as security required under the Supplemental Contract (Exhibit D, Rec. p. 73), which bond provides as follows (fols. 222-5):

> "That pursuant to the act of October 6th, 1917 (Public No. 64-65th Congress) United States of America by supplemental contract dated May 22d, 1918, has agreed to make an *advance payment* to the Principal, as such contractor, in the sum of One Million, Five Hundred Thousand ($1,500,000) Dollars, upon the terms and conditions specified in the said supplemental contract." * * *
>
> "The condition of this bond is that if the Principal shall fully perform all of the obligations and agreements to be by it performed under the said supplemental contract with changes as aforesaid, if any, and shall return to the UNITED STATES OF AMERICA the full amount of the said *advance payment* of One Million Five Hundred Thousand ($1,500,000) Dollars, *with interest as prescribed therein,* then this obligation shall be void, but otherwise shall be and remain in full force and effect."

The condition of this bond is for the repayment by the Butterworth-Judson Corporation to the United States of America of a definite debt of $1,500,000, *and interest,* under the terms and conditions specified in the Supplemental Agreement, which clearly refers to the only terms of repayment therein specified, namely, (a) by delivery of picric acid, or (b) by repayment in cash. The terms of the bond recognize the debit and credit relation existing between the Government and Butterworth-Judson Corporation, and the requirement of Butterworth-Judson Corporation to pay interest upon such debt.

Summary.

The salient points indicating that the Government and Butterworth-Judson Corporation did not intend to create an equitable lien upon the advance payments deposited in special accounts in banks are:

1. The supplemental contract creates a clear debit and credit relation between the parties. The contractor bound itself to repay the full amount of *the debt,* even though the special accounts had been lost through failure of any of the banks.

2. The contract requires the payment of interest upon the debt.

3. The contract provides that the contractors may at any time repay to the Government, in cash, the entire outstanding balance of said advance with interest.

4. The contract specifies definitely the collateral security for the debt and interest, but does

not include, by implication or otherwise, the balances in the special accounts.

5. The contract provides that the note for $1,500,000, bearing interest, which was given as part of the security, should not be negotiated unless there was a default on the part of the contractor.

6. The surety bond given as part security shows by its terms that it covered the repayment of the debt with interest.

7. The contractor could draw upon the special accounts by its own check for any of a very wide number of purposes under the contract without any voucher or other control by the Government.

8. The contract authorized the contractor to draw out the entire $1,500,000 advance payment, covering costs of construction running up to $7,000,000, and, unless required by a Government official, reimbursements need not be redeposited in these special accounts, in which case the so-called fund upon which it is claimed that an equitable lien attached, would have been entirely dissipated.

9. The contract makes no provision that the banks should look to the application of payments out of these special accounts and the appellants admit that no such duty or obligation was imposed upon the banks.

10. The Government did not include the moneys so deposited in special accounts or any balances thereof, as additional collateral security to the debt, and there was no reason for so doing, as the

security actually taken, (a) the note of a responsible contractor and (b) bond of a responsible surety, was amply good. The Government also had a preferred claim against the Company's assets in case of insolvency.

11. The Government could have provided in the contract, if it considered the security offered by the contractor inadequate, that the moneys should be held by a trustee; but it did not do so, and no trust was created by the contract.

12. The Government made its $1,500,000. advance payment by check direct to Butterworth-Judson Corporation, which originally deposited such check in the Chase National Bank, later opening deposits on its own checks in other banks (See appellants' brief, Par. 7, page 11). This was obviously for the purpose of obtaining additional credit to carry out its contract with the Government involving the construction of a $7,000,000. plant and the necessary credit to finance the manufacture of 72,000,000 pounds of picric acid. The complete control given to the Butterworth-Judson Corporation as to checking out these moneys indicates an intention on the part of the Government not to create an equitable lien on the money advanced.

13. The Government cancelled its contract with Butterworth-Judson Corporation on December 6, 1918, at which time there were deposit balances in the special accounts with the banks, and a large indebtedness from the Butterworth-Judson Corporation to the Government. The bill of complaint makes no claim that the Government notified the banks that it asserted any kind of a lien or equi-

table claim upon these moneys at this or any other time until the bringing of the suit on January 8, 1923, more than four years afterwards. This is strong evidence of the construction placed upon the contract by the Government itself.

14. The Government knew on December 6, 1918, that Butterworth-Judson Corporation owed it moneys, and also knew or could have easily ascertained at that time the amount of the balances in the banks. It is unreasonable to assume that the Government would not have given some notice to the banks of its alleged lien had it considered that it had a lien under the terms of its contracts.

15. Butterworth-Judson Corporation agreed under the contract to use the money received from the advance payment for certain purposes, but nowhere in the contract did it agree to repay the Government *out of such advances.*

16. Butterworth-Judson Corporation was to use the moneys for the general purposes of constructing the plant and manufacturing picric acid. That use ceased with the cancellation of the contract by the Government on December 6, 1918.

There is no claim that Butterworth-Judson Corporation did not use these moneys during all the period up to the date of the cancellation of the contract for the specific purposes provided in the contract. The banks did not exercise the right of setoff until nearly four years later, on the day before Butterworth-Judson Corporation went into the hands of receivers, April 21, 1922. There is no claim in the bill that the Government at any time, either before or after the date when it cancelled the contract, notified the banks that it asserted

any lien against these deposit balances. These acts of the Government certainly demonstrate the absence of any belief on its part that it possessed an equitable lien on the balances remaining in the special accounts.

17. Reference is made in appellants' brief (p. 14) to the fact that, except in one case, the loans of the banks were made subsequent to the date of the cancellation of the contract between the Government and the Butterworth-Judson Corporation on December 6, 1918, implying thereby that the rights of the parties became fixed on that date and that the equities in connection with the banks' applying these deposit balances against their larger debts just before the receivership of April 21, 1922, were seriously weakened.

It would seem that the reverse of this argument is true. When the Government cancelled its contract on December 6, 1918, it had definite knowledge that the full amount of the $1,500,000 advanced by it to the Butterworth-Judson Corporation had not been repaid and knew or had every opportunity to ascertain the amount of the deposit balances in the respective banks where special accounts existed. On April 22, 1922, the Butterworth-Judson Corporation went into the hands of receivers. At no time during this period of three and a quarter years, and in fact not until January 8, 1923, did the Government see fit to notify the banks or in any way make claim of any title to, or lien upon, these deposit balances.

In fact, the bill of complaint makes no allegation of notice to the banks of any claim whatever as against these deposit balances, all of which is absolutely inconsistent with the idea that

any such lien was within the intendment of the parties at the time of the making of the contract.

18. In addition, the bill does admit (paragraph 24, fol. 83) and it appears in the statement of account of Butterworth-Judson Corporation to the United States of America (page 104), that Butterworth-Judson Corporation had "repaid to the United States of America as set forth in paragraph 24 of the bill of complaint in the action commenced January 10, 1923, $348,550."

Can it be assumed that at the time of this repayment the Government, knowing that there was still money due from the Butterworth-Judson Corporation on account of the advance of $1,500,000, if it believed it had an equitable lien, would have failed to notify the banks in which deposit balances existed of their claim of such lien thereon?

CONCLUSION.

We believe it is clear that neither of the parties to the Supplementary Agreement of May 22, 1918, intended that the moneys advanced by the Government, under authority of Act of Congress, to Butterworth-Judson Corporation should constitute a fund which was to be held *as security* for the $1,500,000 debt of that corporation to the Government. If there was no such intention, no equitable lien existed, and the set-off by the banks was proper, as was held by the court below.

POINT III.

Unless the $1,500,000 advance was received by the Butterworth-Judson Corporation subject to a trust or equitable lien in favor of the Government, the right of the banks, as against the Butterworth-Judson Corporation, to make the set-off cannot be questioned in this proceeding; nor could that right be successfully assailed even by the receivers of the Butterworth-Judson Corporation.

Appellants in their "Second Point" contend in effect that, even though the contracts created neither a trust in, nor an equitable lien upon, the moneys advanced, nevertheless the banks had no right of set-off and the Government is entitled in this suit to enforce the rights of the Butterworth-Judson Corporation and its receivers against the banks.

There are two answers, each sufficient, to this proposition:

(1) If the Government is merely a creditor of the Butterworth-Judson Corporation and possessed no equitable lien on the special accounts, it has no standing in this proceeding to enforce the rights of that corporation (which is not appealing) against the banks, even though the set-offs were wrongful.

(2) In all the cases cited by counsel for the Government, in which off-set was denied, there is to be found *an agreement, express or implied,*

benefit of some third party. This amounts to the creation of a trust, equitable assignment or equitable lien with respect to such deposits.

It therefore follows that none of these cases cited by counsel for the appellants where off-sets were denied, have any bearing upon this case, unless this Court finds that there was either a trust, an equitable assignment or equitable lien.

A.

Unless the relation between the Butterworth-Judson Corporation and the Government was a trust as alleged in the bill, the Government has no standing to enforce any rights of that corporation against the banks.

It will be remembered that both the Government's bill of complaint and the answer of the defendant surety companies allege that the moneys advanced by the Government and deposited in the banks by the Butterworth-Judson Corporation were "trust funds" (fols. 75, 332) and that the banks had due notice that these deposits were "moneys belonging to complainant" (fols. 89, 375). *Manifestly, no recovery against the banks could be justified under these pleadings unless it were established that the advances were received and held by the Butterworth-Judson Corporation as trustee for the Government.*

An examination of the cases in which the right of the depositary bank to set-off a deposit against a debt of the depositor has been denied shows that in all of them the rights of the depositor against the bank have been asserted by:

1. The depositor himself or his personal representative, trustee in bankruptcy, assignee for creditors, or receiver;

2. A person having an interest in the deposit as *cestui que trust* or lienholder;

3. A person standing in the position of equitable assignee of the deposit, such as the holder of a check drawn against a deposit which was accepted by the bank upon the understanding that it was to be used to meet the check in question.

In no case that we have seen has a mere creditor of the depositor been allowed to enforce the latter's rights against the depositary bank, although of course a situation is conceivable in which a judgment creditor might be allowed to maintain a creditor's suit for that purpose. But by no stretch of the imagination can the Government's bill of complaint in this case be regarded as a creditor's bill, and it is hardly necessary to cite authority in support of the proposition that the rights of action of the insolvent Butterworth-Judson Corporation vested in its receivers, and cannot be asserted by a simple creditor of the Corporation, even though that creditor be the United States.

B.

Unless the advance payment deposited in the special accounts by Butterworth-Judson Corporation was subject to a trust or equitable lien in favor of the Government, the banks were clearly entitled to set-off the deposit balances held by them respectively against the larger debts owed to them by the Butterworth-Judson Corporation.

It is conceded in appellants' brief (p. 41) that the deposits here involved were not technical "special deposits" in the sense that the identical money deposited must be kept and returned to the depositor, and also that they do not fall into that class of cases "where money is deposited in a bank with instructions to the bank itself to act as agent for the depositor to apply the money to a designated purpose."

But the appellants contend (p. 41) that these deposits belong to a class "where the depositor deposits money with the bank, title thereto passes to the bank as in the case of the ordinary general deposit, but where the depositor, at the time of making the deposit, notifies the bank that the money is deposited for the purpose of being applied by the depositor himself through the medium of checks drawn against it to some special object or purpose". In this class of cases, say the appellants, "the knowledge of the bank of the purpose to which the depositor is determined to dedicate the money, and the acceptance of the deposit with such knowledge, prevent the bank from asserting its right of set-off so as to defeat the application of the money to the designated purpose".

That is to say, although there is nothing in existence except an indebtedness of the bank to the depositor, the bank cannot set this off against an indebtedness of the depositor to it, merely because it accepts the deposit with knowledge that the depositor intends to check it out for some special purpose—such as the purchase of an automobile.

No authorities are cited by the appellants which bear out the sweeping assertion, that mere notice to or knowledge of a bank that a deposit is to be used for a certain purpose destroys the right of offset.

An examination of the decisions shows that the courts have gone no further than to hold the bank to be estopped by its own *agreement*, express or implied, that the deposit should be used only for a specified purpose, usually for the benefit of a third person, in whose favor a trust thereupon arose (*Turkington v. First Nat. Bank*, 97 Conn. 303; *Peterson* v. *Crawley*, 38 S. Dak. 597; *Woodhouse* v. *Crandall*, 197 Ill. 104), as where the deposit was accepted by the bank upon the understanding that it was to be used for the benefit of all of the depositor's creditors (*Lynam* v. *Belfast*, 98 Me. 449; *Fitzgerald* v. *State Bank*, 64 Minn. 469; *Wagner* v. *Citizens Bank & Trust Co.*, 122 Tenn. 164; *Continental Nat. Bank* v. *Moore*, 229 Fed. 270), or where the bank accepted the deposit with the understanding that it was to be used to meet certain checks of the depositor then outstanding or to be drawn in favor of a specified person (*Walters Nat. Bank* v. *Bantock*, 41 Okla. 153; *First Nat. Bank* v. *Barger*, (Ky.) 115 S. W. 726; *Dolph* v. *Cross*, 153 Iowa 289; *Wilson* v. *Dawson*,

52 Ind. 513), or where, to the knowledge of the bank, the money deposited belonged to a third person and was made for the express purpose of meeting a check drawn by the nominal depositor for the accommodation of such third person (*Straus* v. *Tradesmen's Nat. Bank*, 36 Hun (N. Y.) 451, affirmed 122 N. Y. 379).

Unless, to the knowledge of the bank, the money deposited is held by the depositor in a fiduciary capacity, such as trust or agency, or subject to a lien, or unless the bank expressly or impliedly *agrees* to an application of the deposit *inconsistent with its right of set-off*, the bank may lawfully apply the deposit in satisfaction of its own claim against the depositor.

The cases in which the right of set-off has been denied, where the money deposited belonged to the depositor and was subject to his check, boil down to the simple proposition that the bank will not be permitted to violate the agreement, express or implied, under which it accepted the deposit.

The New York Court of Appeals in *Straus* v. *Tradesmen's Nat. Bank*, 122 N. Y. 379, 382, said:

> "As a rule a deposit made in a bank by a person on general account becomes its fund, and the relation between the depositor and the bank is that of debtor and creditor, and, *in the absence of any agreement to the contrary*, the bank is at liberty to apply the money upon a demand due to it from the depositor".

In the case before this Court there was no agreement by the banks, and the mere knowledge of the terms of a contract which does not create an equitable lien in favor of the Government, did not destroy the banks right of off-set.

The mere fact that money is deposited in a special, rather than in the depositor's general account, or that the bank has knowledge that the depositor intends to use it for a particular purpose does not vary that rule.

In re Interborough Consol. Corp., 288 Fed. 334, 347, (C. C. A., 2d Circ.), the court said:

> "If a fund is deposited in a bank for a specific purpose, but subject to the depositor's check, it remains the property of the depositor, and is subject to the right of set-off. *Continental Trust Co.* v. *Chicago Title Co.*, 229 U. S. 435, 446".

In *Continental Trust Co.* v. *Chicago Title Co.*, 229 U. S. 433, a trustee in bankruptcy sued to recover a deposit balance of the bankrupt amounting to $575.79 which had been offset by the depositary bank. It appeared that the bank had agreed with the bankrupt that, if he would make deposits for such purpose, it would pay certain salary and payroll checks of the bankrupt and checks issued to the Board of Trade Clearing House. The trustee claimed that there was no right of set-off as to this deposit, because it was not treated by the parties as a general deposit, but was made "under special circumstances" amounting to a special deposit. This Court said at page 446:

> "As to the $575.79, we think the right to set-off this deposit is established by the principles laid down in *New York County National Bank* v. *Massey* (192 U. S. 138). Here there was a deposit *subject to be checked out by the bankrupt for specific purposes*".

In the present case, as has been shown in Point II, *supra*, the moneys deposited were held by the

Butterworth-Judson Corporation free of any trust or lien in favor of the Government. The only further question (assuming that appellants are entitled to raise that question) is whether there was any *agreement*, express or implied, by the banks, *with the Butterworth-Judson Corporation* which estopped them from making the set-offs. The conduct of the parties with respect to these deposits was wholly inconsistent with any such agreement or understanding.

As is stated in appellants' brief (p. 11) the whole of the $1,500,000 was originally deposited with the Chase National Bank and portions thereof were subsequently withdrawn by the Butterworth-Judson Corporation and deposited in special accounts in the other appellee banks, all of which either at the time of deposit or thereafter made large loans to the depositor. It is said in appellants' brief (p. 2) that these loans were "unsecured", but the only fair inference is that the deposits were made for the purpose of obtaining credit from those banks and that both the banks and the depositor understood and intended that the loans should be made upon the faith of the deposits.

In the case of this particular appellee, National Newark & Essex Banking Company, appellants' brief admits (p. 13) that on June 4, 1918, $250,000 was deposited in this bank and *on the same day* the bank made a loan of $250,000 to the Butterworth-Judson Corporation.

It is asserted by the appellants that the banks accepted these deposits "with full knowledge of the restrictive character of the 'Special Account' deposits". But that means nothing unless (1)

the contract created a trust or equitable lien in favor of the Government, or (2) the acceptance with such knowledge amounted to an *agreement* by the banks with the *Butterworth-Judson Corporation* not to offset. The only knowledge which the banks can be assumed to have had was of the contract itself.

Assuming, therefore, that the banks were furnished with copies of the Supplementary Agreement, they learned therefrom that the Butterworth-Judson Corporation had contracted with the Government to

> "deposit the money advanced hereunder in special accounts in banks, separate from its other funds, and shall draw on said accounts only, in payment of the expenditures made and obligations incurred in designing, constructing and equipping the plant specified in the Principal Agreement, and for other equipment and for material, labor and overhead expense, required in the direct performance of the Principal Agreement, unless otherwise authorized in writing by the War Credits Board" (fols. 192-193).

In addition, the banks also learned:

(a) That the Government had, by check, made an advance payment to Butterworth-Judson Corporation of $1,500,000 on account of picric acid to be delivered;

(b) That Butterworth-Judson Corporation had agreed to repay this debt, with interest;

(c) That Butterworth-Judson Comporation had given collateral security for the debt, in the shape of its own note for $1,500,000, with interest, and a $750,000 bond of a responsible surety company;

Why not this?

(d) That the Government, upon default by Butterworth-Judson Corporation in the payment of its debt, could sell the corporation's note and realize upon its surety bond;

(e) That the contract said nothing whatever about the moneys deposited in special accounts being security for the debt;

(f) That the contract did not impose any obligation upon depositary banks to see to the application of the deposits.

Could the acceptance of the deposits with such knowledge possibly amount to an agreement by the banks with the Butterworth-Judson Corporation to hold the deposits free from any claims of their own against the depositor on account of the loans made to it? Although the moneys were deposited in special accounts, they were subject without qualification to withdrawal upon the depositor's checks, and there is nothing whatever from which it may fairly be inferred that the banks understood or agreed that the deposits should be held by them for any purpose more specific than to pay such checks, and when the contracts were cancelled on December 6, 1918, they still held the deposits subject to the check of the Butterworth-Judson Corporation.

The following letter (fols. 622-627) sent by the Butterworth-Judson Corporation to the National Newark & Essex Banking Company at the time the deposit was made in that bank, speaks for itself:

"BUTTERWORTH-JUDSON CORPORATION
61 Broadway, New York, 6-4-18

National Newark & Essex Banking Company,
Newark, New Jersey.

Dear Sirs:

ATTENTION OF MR. CHARLES L. FARRELL, PRES.

In accordance with our conversation over the telephone, we enclose herewith checks payable to your account for $250,000 and $10,000. You will kindly note that the deposit of $250,000 is to be designated as the BUTTERWORTH-JUDSON CORPORATION SPECIAL ACCOUNT. The one for $10,000 to be Butterworth-Judson Corporation but this is to be the regular account and the one that is to get the proceeds of your loan to us when this is granted. The deposit of $250,000 is part of the advance payment made to us by the United States Government on a contract granted us, and though we will draw checks against this down to approximately 50% and we will no doubt reimburse this amount from time to time. The United States Government demands that we draw the usual interest granted to deposits of this kind, so that we assume you will allow us at least 2% interest on this account.

"We also enclose certified copy of a resolution passed at a meeting of the Board of Directors of the Butterworth-Judson Corporation authorizing the President, Mr. W. A. Bradford, to borrow from you the sum of $250,000, and to open up an account with your bank, and to do any and all things necessary to complete this transaction. You will also please note that either checks drawn on the regular account or special account are to be signed by any two of the following officers: W. A. Bradford, President; G. A.

MacIntosh, Vice President, Edw. Spahr, Vice President and N. W. Runnion, Treasurer. Specimen signatures of these gentlemen will be forwarded to you as soon as we receive your specimen signature cards.

"Kindly forward us pass books and check books for each of the above accounts; also a few blank notes of the kind we will have to use on your loan. Mr. Bradford did not say anything as to the period the money was to be borrowed for or the rate, so will you kindly write us your ideas on this. If there is any further information you desire, kindly telephone the writer and he will call to give you the information desired.

"Thanking you, we remain,

Very truly yours,

BUTTERWORTH-JUDSON CORPORATION,
N. W. RUNNION,
Treasurer."

NWR:FB
ENCL.

Manifestly, all that the depositary banks agreed to do was to pay out the deposits against properly drawn checks of the Butterworth-Judson Corporation. They did not undertake to see to the application of the proceeds of such checks to the purposes specified in the Government contracts.

If the moneys when deposited were free from any trust or lien in favor of the Government, the banks did not by any understanding or agreement with the Butterworth-Judson Corporation estop themselves from setting the deposits off against the loans which they had made to that corporation.

Consequently, not even the receivers of the Butterworth-Judson Corporation would be entitled to recover those deposits, and *a fortiori* the Government, if it occupies the position of a mere creditor, cannot do so.

POINT IV.

Discussion of supposed cases in appellants' brief.

At pages 24 to 26 counsel for appellants presents a number of supposititious cases and questions, and argues that the conclusion in favor of an equitable lien is so clear in the "supposed" cases that the same conclusion must be made in the present case.

We refer to these merely for the purpose of bringing out the legal principles which we believe the courts have applied in all cases with respect to equitable liens.

Case A, with respect to the right of a bank to offset a deposit of advanced rents, must depend wholly upon the character, terms and circumstances under which the deposit was made with the bank. If the improvements were to be paid for solely out of the deposit and the control of the deposit had passed out of the hands of the party making the advance payment, the fund being designated *as security* for such improvements and the bank received the same with full knowledge, clearly an equitable lien would arise and an offset would not be proper.

Case B. Again, if the Government advanced money to the railroad company and the moneys were deposited under the terms of an agreement, of which the bank had notice, and in which they were specified to be *security* for the repayment to the Government, then an equitable lien would certainly arise and the bank set-off would be im-

proper. If a contrary state of facts existed, and the moneys were not specified to be *security,* the offset would be proper.

Case C. The same principle applies.

Case D inquires whether an injunction would lie against the banks to restrain an immediate offset for their debt against the $1,500,000 deposited in special accounts. It is clear that as between the parties, the Government and Butterworth-Judson Corporation, legal proceedings by injunction could be taken to restrain an improper use of the funds, but it clearly would not lie against the banks unless the contract itself, of which the banks had notice, creates an equitable lien on the deposits in favor of the Government.

Case E. In this supposition, clearly the Government could proceed, by injunction, to restrain Butterworth-Judson Corporation from diverting the funds, but it would be upon the specific terms of the agreement between the two parties as to the use of the funds, and not because the Government had an equitable lien upon the funds. The conclusion of counsel that, because the Government has a right to see that the terms of its own contract are carried out by Butterworth-Judson Corporation, therefore an equitable lien was created upon the special accounts, is utterly fallacious.

The appellants conclude (paragraph 3, page 27 of brief) that the only way in which any effect could be given to the provisions of the contract is to impress the special accounts with the character of a trust or an equitable lien. This does not follow.

The contracts between the parties were drawn under the authority of a specific statute. Under

this authority an advance payment for the purchase of supplies of $1,500,000. was made. The contractor was bound to repay these moneys with interest and agreed to do so. Definite security was provided for and given to the Government. In the event of default, definite provision was made with respect to the security, the Government agreeing to return to the contractor any surplus over its debt.

It is therefore difficult to see how any such conclusion can be reached to the effect that the provisions of the contract could not be carried out unless the special accounts are impressed with the character of a trust or an equitable lien, as claimed by counsel for appellants in this case.

POINT V.

The decree appealed from should be affirmed.

Respectfully submitted,

BREED, ABBOTT & MORGAN,
Solicitors for Appellee, National Newark & Essex Banking Co., Newark, New Jersey.

WILLIAM C. BREED,
EDWARD J. REDINGTON,
Of Counsel.

SUBJECT INDEX.

INDEX OF AUTHORITIES

Supreme Court of the United States.

UNITED STATES *et al.*,
Appellants,

AGAINST

BUTTERWORTH-JUDSON CORPORATION,
CHASE NATIONAL BANK *et al.*,
Appellees.

October Term,
1924.
No. 388.

APPEAL FROM THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR CHASE NATIONAL BANK OF THE CITY OF NEW YORK, NEW YORK TRUST COMPANY AND AMERICAN EXCHANGE NATIONAL BANK.

Statement.

This appeal comes before this court from an order of Hon. Augustus N. Hand, *D. J.*, dated June 28, 1923, affirmed by the Circuit Court of Appeals, Second Circuit, February 25, 1924 (297 Fed. 971), dismissing, for insufficiency as to the defendant banks, appellant's bills in equity, as well as certain counterclaims of the appellants, surety companies, pleaded against the defendant banks.

The appellant seeks the recovery back, as trust funds and as property of the United States, of $611,450.00, a balance remaining unearned of an

advance payment made May 22, 1918, to a picric acid contractor, Butterworth-Judson Corporation, of which amount $519,631.99 was on deposit in the Banks.

The defendants named are, (*a*) Butterworth-Judson Corporation, which received payments of $1,500,000 from the Government on May 22, 1918, to apply against the purchase price of picric acid to be manufactured under a Principal and Supplemental Agreement, dated, respectively, May 9 and May 22, 1918, and attached to the bill; (*b*) the receivers of Butterworth-Judson Corporation, appointed by the United States District Court in Equity, April 22, 1922; (*c*) certain banks in which the advance payment was deposited and which afterwards made loans to Butterworth-Judson Corporation and applied the balance of the deposits against such loans April 21, 1922; (*d*) eight surety companies, obligated *inter alia* to the United States on an apportioned bond of $750,000 for the repayment of the balance described above.

The appeal is nominally by the United States, the complainant, but the surety companies are in fact the only parties interested therein, as will presently appear.

The prayer of the bill (R. p. 32 *et seq.*), so far as pertinent here, asks (*a*) as against the banks (paragraph 5) that the funds in bank "with interest thereon" be decreed "impressed with a trust in favor of the United States", and in paragraph 6, that the funds be decreed "with interest" to be "the money and property of the complainant" and be paid over to it; (*b*) as against the surety companies, it asks (paragraph 11) judgment for any balance of the $1,500,000 advance payment found due the United States. The bill stands, so far as

defendant surety companies are concerned and as to Butterworth-Judson Corporation and its receivers. The dismissal applied only to the claims against the banks, the appellees.

The receivers were appointed April 22, 1922, and on April 21, 1922, the banks had offset the funds in suit against their various loans, for concededly, the banks, after the $1,500,000 had been deposited amongst them, loaned Butterworth-Judson Corporation $1,250,000 (Appellants' Brief, p. 11 *et seq.*). The situation as to these loans *before* the application of the deposits was as follows (R. p. 31):

	Loans	Balance of Deposit April 22, 1922
CHASE NATIONAL BANK.		
Aug. 30, 1920.....	$250,000	
Sep. 7, 1920.....	350,000	
Total	$600,000	$232,844.80
NEW YORK TRUST COMPANY.		
July 21, 1919.....	$100,000	70,119.49
THE AMERICAN EXCHANGE NATIONAL BANK.		
Jan. 10, 1921.....	$100,000	
Mch. 28, 1921.....	200,000	
Total	$300,000	115,501.60
NATIONAL NEWARK & ESSEX BANKING COMPANY.		
June 4, 1918.....	$250,000	101,166.10
Totals	$1,250,000	$519,631.39

In sum, then, at the time of the receivership the total deposits in the banks had been reduced to

$519,631.99. So that, after the application of the deposits to the reduction of the aggregate loans of $1,250,000, there yet remains unpaid to the banks an aggregate of $730,368.01. The deposits thus applied, *i. e.*, $519,631.99, are sought to be recovered from the banks by the complainant, United States, which desires to apply them in reduction of a balance of $611,450 due from Butterworth-Judson Corporation to the complainant (p. 14, Appellants' Brief). This, then would leave the surety companies with only $91,810.01 to pay under their bond of $750,000, should the bill and counterclaims be sustained. With the bill dismissed as to the banks, the sureties must pay the full amount due the United States, or $611,450. They then become subrogated to the rights of the United States, viz., to prove as a creditor and presumably to demand payment in full before general creditors, just as the United States could.

It is plain, then, that the United States, the nominal appellant, secured by a valid bond of $750,000, has no real interest in this appeal. The sureties are the only parties to benefit by a reversal.

This bond, for $750,000, was given as part of the security under the Supplemental Agreement, in accordance with which the advance was made. Another bond, for $500,000, Exhibit C annexed to the bill (R. p. 67), was given by the same sureties to secure the performance of the Principal Agreement. So that the total security taken by the Government under the Principal and Supplemental Agreements is $1,250,000.

The answers of the surety companies set up counterclaims against the banks, as is proper under the Equity Rules, seeking identical relief with that

demanded by the United States in the bill. These counterclaims, too, were dismissed and the appeal is taken, in turn, by these companies. So that the bill and the counterclaims can be treated together in this discussion.

The question here is based on the pleadings. They are before the Court and will not be repeated *in extenso* in this statement. The appellees do not, however, agree to the statement contained in appellant's brief so far as it includes conclusions, italics and the like. Particularly the appellees deny there is anything in the bill to justify such statements as that on page 3 of appellant's brief, that it was customary to deposit advance payments in special accounts; or on page 4 that advances in other cases are to be noted; or on page 14 that "by *concert of* action between the Banks" the funds were applied, etc. The matters for discussion are four-fold. They will be treated in the order following, viz:

I. The contracts between the United States and Butterworth-Judson Co., created simply the relation of debtor and creditor (*infra,* p. 5).

II. No equitable lien exists in favor of the United States against the fund (*infra,* p. 28).

III. A complete right of setoff accrued to the banks on making the loans (*infra,* p. 38).

IV. Comments on the opinion of the Circuit Court of Appeals, appellants' arguments and the general equities revealed (*infra,* p. 41).

(Italics throughout are not found in the originals.)

I.

The contracts between the United States and Butterworth-Judson Co. created simply the relation of debtor and creditor.

At the outset a word or two should be said as to the theory on which this action was brought. An examination of the bill, paragraph Fifteenth (R. p. 25) reveals the original notion of the complainant, United States, to have been that the advance and the moneys in replenishment thereof "were a trust fund" and "complainant was and now is in equity entitled thereto or to any balance remaining thereof."

Again, paragraph Thirty-First (R. p. 32):

> "That the moneys remaining on deposit in said accounts with said respective defendant banks are the property of complainant * * *,"

and in the prayer for relief, paragraph 2 (R. p. 33) the receivers are asked to account for the balance of $1,500,000.

Again, in paragraph 5 of the prayer (R. p. 34) it is prayed that these balances:

> "be decreed to be impressed with a trust in favor of complainant as against said respective bank defendants and all other persons."

Also, paragraph 6, that it be decreed that the balance:

> "with interest, in excess of withdrawals duly made therefrom by defendant Butterworth-Judson Corporation, are the money and property of the complainant, and that said bank

defendants be each of them ordered to pay over the balances remaining with each of them respectively out of said respective deposits, and interest, to complainant."

Turning now to the answer of the defendant, American Surety Company *et al.* (R. p. 105 *et seq.*) we find somewhat similar averments (paragraph Fifth-Sixth, R. p. 125, fol. 375; paragraph Fifty-Eighth, R. p. 126).

It appears, then, that the original theory of this action was that the funds in suit were a trust fund, impressed with a trust in favor of the United States, so far as they had not been expended upon checks duly drawn against the special accounts by Butterworth-Judson Corporation. The case was thus, in chief, presented to the District Court and the Circuit Court of Appeals, as appears by the opinions of the Courts below (R. pp. 263 and 312). It was, also, urged in both these courts that an equitable lien existed in favor of the United States against the balance of the funds and this point was covered by the opinion in the Circuit Court of Appeals, at the end of the opinion (R. p. 319). Apparently the appellants have abandoned the strict trust fund theory and rely upon the theory of an equitable lien and a waiver of the right of setoff (App. Brief, p. 28), so that, in order that this question may be completely disposed of, it is desirable that both these grounds be examined.

Although the phraseology of the pleadings is competent to show the theory of the action, yet it must be conceded that whatever relation exists between the parties is to be spelled out from the two contracts, Exhibits A and B, annexed to the bill. It is a well recognized rule of pleading that where a bill summarizes the contents of a docu-

ment and a copy of that document is attached, the court will look to the attached copy and regard that as controlling rather than what the pleader says as to its contents.

United States v. *Ames,* 99 U. S. 35;
Greeff v. *Equitable Life Assur. Soc.,* 160 N. Y. 19 (29).

Following this rule several pages of the bill and counterclaims, which are given up to the superfluous task of summing up the contents of the attached exhibits, may be disregarded. So, too, that portion of the bill which alleges that these were "trust funds", has no weight. It is a pure conclusion and may be disregarded. It is the province of the court, having before it the documents, to determine whether there was a trust fund. This was directly held in:

McMonagle v. *McGlinn,* 85 Fed. 88, and
Binkowski v. *Moskiewitz,* 144 A. D. 161.

In each of these cases there was a general allegation that the funds, the subject matter of the action, were held "in trust" for the complainant. In each case judgment was given on demurrer, dismissing the bill and ignoring the conclusion pleaded.

At the outset it is apparent that, unless the fund received by Butterworth-Judson Corporation, and described as an advance payment for picric acid, became a trust fund with a true trust relation existing between Butterworth-Judson Corporation and the United States by reason of the Principal and Supplemental contracts in question, then, certainly, no trust relation arose between the banks and the United States, for the former, at the most, were mere depositories, with notice of the terms

under which the moneys were advanced by the United States.

At the foundation of the relation which arose by reason of the advance is the Act under which the payment was made. This Act is brief and reads as follows:

> U. S. Compiled Statutes, Section 6648-*a* (Oct. 6, 1917):
>
> ADVANCES OF PUBLIC MONIES TO CONTRACTORS FOR SUPPLIES BY SECRETARIES OF WAR AND NAVY.
>
> The Secretary of War and the Secretary of the Navy are authorized, during the period of the existing emergency, from appropriations available therefor, to advance payments to contractors for supplies for their respective departments in amounts not exceeding 30% of the contract price of such supplies: provided, that such advances shall be made upon such terms as the Secretary of War and the Secretary of the Navy, respectively, shall prescribe and they shall require adequate security for the protection of the Government for the payments so made."

The purpose of this Act was to do away with the force of the decision of this court in *Matter of Floyds Acceptances*, 7 Wall 666. That decision held, in effect, that it was illegal for the Government to advance moneys for supplies.

It is a fact of common knowledge that a state of war was in existence on October 6, 1917, and that in the conduct of the war the War Department was in pressing need of picric acid, the basis of most of the high explosives used by the army of the United States. Picric acid, therefore, comes under the head of supplies to the War Department. Obviously, the aim of the War Department was to obtain an imme-

diate supply of picric acid, and to expedite the procurement of this commodity it was found necessary to make advances to contractors for the building of plants and the installation of equipment incidental to its manufacture. With that purpose in mind an examination of the Principal and Supplemental Agreement, Exhibit A (R. p. 38) and Exhibit B (R. p. 61) is essential. One conclusion only can be arrived at from such examination, viz., that the advance of $1,500,000 was

Payment for Picric Acid.

It being a payment for supplies, it could not well thereafter be considered a trust fund for the benefit of the Government, nor the property of the Government, as the bill seeks to establish.

Taking up, first, the Principal Agreement, we find this entitled:

"Contract for 72,000,000 Pounds of Picric Acid".

The opening clause of the contract (R. p. 39) is that:

> "Whereas a state of war exists between the United States of America and the German and Austro-Hungarian Governments, constituting a national emergency, and the United States requires performance of the work and delivery of the supplies hereinafter described within the shortest possible time;"

The contract then provides in articles II, III, IV, V, VI and VII for the construction of the plant at a cost of $7,000,000, plus $1 as profit. Article XII (R. p. 46) makes provision for payment for picric acid to the contractor at 53 cents per pound so long as the phenol process was used, and thereafter provision makes for an increase

or decrease in price in case of change in materials. This is followed by the important article XVI (R. p. 50), in brief, that the contracting officer should recommend to the War Credits Board:

> "an *advance payment* to the Contractor for the *supplies* herein contracted for in the sum of one million five hundred thousand ($1,500,000) dollars upon such terms and conditions and *secured* in such manner as said Board shall prescribe."

The contract itself was made dependent upon the approval for such advance payment, for it was provided in this same article that if the advance payment should not be approved, the contractor might notify the contracting officer:

> "that it elects to terminate this contract."

This, then, was the basic agreement under which the $1,500,000 was to be advanced. It is there described as an "advance payment". In other words, the Government was paying for the supply of picric acid in advance rather than after its delivery.

Even more conclusive evidence of this fact is found in the agreement containing the terms under which the advance was made, Exhibit B (R. p. 61), based, of course, upon the general authority given in the Principal Agreement, Exhibit A. This supplementary agreement has this significant caption:

> "SUPPLEMENTARY AGREEMENT BETWEEN BUTTERWORTH-JUDSON CORPORATION, CONTRACTOR AND UNITED STATES OF AMERICA
> COVERING ADVANCE PAYMENT TO CONTRACTOR."

In Article II its purpose is clearly set forth:

> "In the interest of both parties hereto and in order to expedite the delivery of the said sup-

plies the Government shall advance to the contractor under the principal agreement an amount not exceeding the sum of One Million Five Hundred Thousand Dollars ($1,500,000) on the terms *and security* hereinafter mentioned and shall make payment by check directly to the contractor."

The next article provides for the method of accounting for the advance, and it is there said:

"Art. III. The contractor shall account to the Government for the amount of said advance, with interest on the outstanding balance of said advance at the rate of seven per cent per annum for the month of May, 1918, and thereafter at such rate as the War Credits Board may determine from month to month, by applying and crediting the said advance with interest to the payment of vouchers presented by the contractor to the Government, covering deliveries of picric acid under the Principal Agreement, as follows:"

From the foregoing it is clear that the plain purpose of this agreement was to secure an immediate supply of picric acid by paying $1,500,000 in advance. The advance then came clearly within the Act of October 6, 1917, quoted above, and its purpose was in accordance with the terms of that Act:

"to advance payments to contractors for supplies."

Whether or not the fund thus created could properly be styled a "revolving fund", as appellants claimed, is of no importance, as that term is one of elastic meaning and, in any event, implies no trust relationship. There is this fact to be noted, however, the Supplemental Contract provided for the repayment of these funds by credits on deliv-

eries of picric acid. As soon as the full amount of $1,500,000 had been repaid to the Government, with interest, by deliveries of picric acid, then the transaction was closed and thereafter deliveries would be paid for as made, article XII (R. p. 46).

That the $1,500,000 was a payment in advance for supplies, appears also in the surety company bond annexed as Exhibit D to the bill (R. pp. 74 and 75), where it is provided:

> "That pursuant to the act of October 6th, 1917 (Public No. 64-65th Congress) United States of America by supplemental contract dated May 22d, 1918, has agreed to make an advance payment to the Principal, as such contractor, in the sum of One Million Five Hundred Thousand (1,500,000.00) Dollars, upon the terms and conditions specified in the said supplemental contract."

The foregoing quotations show clearly that the balance of $1,500,000 did not remain the property of the United States, as the bill and counterclaims seek to establish. Once a payment is made for commodities, either before or after their delivery, the funds paid become the property of the payee. It is idle to suppose that funds thus transferred, although described as a payment for supplies, remain the property of the payor.

This brings us then squarely to the question of whether the conditions surrounding the payment impress the funds with a trust.

The appellants have been forced to abandon the trust fund theory by reason of the rules laid down by the courts.

A trust can only be inferred where it is established by clear language and intent. No doubtful or uncertain language will suffice. Judge Hough

says, in *Beaver Board Cos.* v. *Imbrie, et al.,* (C. C. A.) 296 Fed. 670, at page 672:

> "What is necessary, as all agree, is an explicit declaration of trust, or circumstances showing beyond reasonable doubt that it was intended to create a trust."

In *Wadd* v. *Hazelton,* 137 N. Y. 215, Judge Peckham said (p. 219):

> "We are also of the opinion that no trust was proved.
>
> While it is true that no particular form of words is necessary to create a trust of this nature, and while it may be created by parole or in writing, and may be implied from the acts or words of the person creating it, yet it is also true that there must be evidence of such acts done or words used on the part of the creator of the alleged trust, that the intention to create it arises as a necessary inference therefrom and is unequivocal; the implication arising from the evidence must be that the person holds the property as trustee for another. The acts must be of that character which will admit of no other interpretation than that such legal rights as the settlor retains are held by him as trustee for the donee * * *."

The Principal and Supplemental Agreements, which must be the basis of the trust, if one was created, contain plain indicia of the debtor and creditor relation and not of the trust relation. These are as follows:

(*a*) The language of Art. XVI Principal Agreement and Art. VI of the Supplemental Agreement, which provided for the use of the funds by the contractor.

(*b*) Butterworth-Judson Corporation agreed to pay interest on balances of the fund.

(*c*) Butterworth-Judson Corporation was obliged to and did give the Government collateral security consisting of an interest bearing note (for $1,250,000) and a surety company bond in the amount of $750,000 to secure the repayment of any balance due.

(*d*) Butterworth-Judson Corporation could repay the balance at any time, in cash, with interest.

Right to Use the Funds.

The Principal Agreement, Article XVI, provides (R. p. 50):

> "*Moneys to be advanced by the United States.*—The Contracting Officer shall, upon the delivery of this contract, recommend to the War Credits Board that it approve an *advance payment* to the Contractor for the supplies herein contracted for in the sum of one million five hundred thousand (1,500,000) dollars upon such terms and conditions and *secured* in such manner as said Board shall prescribe. If said Board shall fail to approve the making of said advance payment within ten days from the date of this contract, the Contractor shall have the option of notifying the Contracting Officer that it elects to terminate this contract."

Supplemental Agreement, Art. VI, provides:

> "The contractor shall deposit the money advanced hereunder in special accounts in banks, separate from its other funds, and shall draw on said accounts only in payment of expenditures made and obligations incurred in designing, constructing and equipping the plant specified in the Principal Agreement, and for other equipment and for material, labor and overhead expense, required in the direct per-

formance of the Principal Agreement, unless otherwise authorized in writing by the War Credits Board.

The contracting officer may require that the contractor shall deposit in said accounts funds paid by the Government to the contractor reimbursing the contractor for expenditures made from this advance in designing, constructing and equipping the plant, as provided in Article VI of said contract between the parties hereto, dated May 9, 1918."

If any relation other than debtor and creditor was created, it must be by virtue of these particular provisions.

Here then we have in Art. XVI, Principal Agreement, quoted above, a clear provision for an advance payment and for security to be arranged by the War Credits Board.

The Supplemental Agreement contained the details of the security arranged by the War Credits Board. That agreement provided in the first paragraph of Art. VI a promise by the contractor that the funds deposited shall be used, in general, only in connection with the Principal Agreement and for the expenses of material, labor, etc. Second, we find a further provision that the contracting officer, at his option, might require the contractor to deposit in the account funds paid by the Government to the contractor for the construction of the building. In connection with these clauses of the contract two important omissions, had the purpose been to create a trust fund, are at once noticeable. First, had it been the purpose to create a trust, what could have been simpler than for the agreement to provide that the funds should become trust funds, or that the contractor should be a trustee of the funds, or that the funds should be

impressed with a trust in favor of the United States? Neither the Principal nor Supplemental Agreement has any such words in it. Their absence is significant. Second, had it been the purpose to retain ownership of the funds in the United States, a few apt words would have sufficed for that purpose. What explanation can be given for their omission, except that no trust or retention of ownership was contemplated?

The funds were paid in under an agreement as to how they should be used. The banks were not parties to that agreement, and had no voice in the method of paying out. The utmost that can be charged against them is notice of what Butterworth-Judson Corporation had agreed to. The banks must honor the checks drawn against the account, if properly signed. Beyond that, their duty ceased.

Again, it appears from the foregoing quotation that certain funds may be added to the special deposits in addition to the $1,500,000. These funds came from the repayment by the Government to the contractor of the expense the contractor had undergone in erecting the plant. In sum, it is provided that the contracting officer may require these funds to be deposited in the special accounts. There the two funds became mingled. Can it be contended that once the Government had caused the contractor to advance funds in building the plant under the Principal Agreement, and had repaid the advances thus made, as it was required to do, the funds thus repaid became trust funds? It is inconceivable that any corporation would consent to take its own money and deposit it in a trust fund for the benefit of another. Yet, this is the result reached by appellant's theory.

Interest.

Butterworth-Judson Corporation bound itself to pay interest on the amount advanced to it. Judge Hand, in his opinion, properly held that this was inconsistent with the theory of a trust fund (R. p. 265). As to the fact of interest being charged, there can be no doubt. It is mentioned many times in both contracts and in the prayer for relief. Article III of the Supplemental Agreement (R. p. 62) provides that the contractor shall account to the Government:

> "for the amount of said advance, *with interest* on the outstanding balances of said advance at the date of seven per cent per annum for the month of May, 1918, and thereafter at such rate as the War Credits Board may determine from month to month * * *."

It is further provided (R. p. 63) that the contractor can repay to the Government at any time:

> "the entire outstanding balance of said advance *with interest,*" due thereon.

On the same page it is written:

> "If * * * the Government does not recoup * * * the advance *with any interest due,* or if the contractor shall not furnish to the Government the supplies in whole, or any part thereof, * * * the contractor shall return to the Government, on demand, any balance of the said *advance and interest* after deducting, etc."

and Article IV of the Supplemental Agreement (R. p. 64) stipulates for collateral security and makes the collateral not only for the return "of the above mentioned advance" but also of "any interest due". On the said page at folio 192, it provides for the

sale of the note used as collateral and the application of the proceeds:

> "toward the repayment of the above mentioned advance, *and interest due.*"

Finally, in the demand for relief herein the complainant seeks (R. p. 34) to compel:

> "said bank defendants * * * to pay over the balance remaining with each of them respectively out of said respective deposits *and interest* to complainant."

All this seems to put it beyond peradventure that the advance drew interest. Nor is it of any moment that in fixing the amount that the Government should finally pay the contractor, any interest on the advance payment under article XVII (R. p. 50 *et seq.*) should be reimbursed to the contractor as part of its costs. This simply provided one of the methods under which costs should be made up, as provided in article XIII and article XIV of the Principal Agreement (R. p. 48 *et seq.*). It could not do away with the fact that interest was charged on the account and that it was an interest bearing account. Judge Hand correctly held this a certain indicium of a debtor and creditor relation, rather than a trust relation (R. p. 264 *et. seq.*).

The payment of interest by one to whom money is loaned or advanced, is inconsistent with a trust relation. It is a clear indication of the relation of debtor and creditor. The purpose of paying interest is as compensation for the use of money, but a trustee is not given the use of money. The funds in his hand and all profits and accruals thereon become the equitable property of the beneficiary and the trustee must account therefor. No authority is needed for so clear a principle.

Interest is defined as follows:

It is said in *22 Cyc.*, p. 1469:

> "Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money."

In *Dry Dock Bk.* v. *American, etc., Ins. Co.*, 3 N. Y. 344 (355), interest is defined as:

> "A certain profit for the use of the loan."

And in *Corcoran* v. *Henshaw*, 8 Gray (Mass.) 267 (278), interest is defined as:

> "Money to be paid for the use of capital on a loan of money or the forbearance of a debt and becomes part of and incident to a debt."

Finally, it was said by Mr. Justice Miller in *U. S.* v. *Denvir*, 106 U. S. 264, with regard to interest:

> "That principle is, that where an officer of the Government has money committed to his charge, with the duty of disbursing or paying it out as occasion may arise, he cannot be charged with interest on such money until it is shown that he has failed to pay when such occasion required him to do so * * *.
>
> The obvious reason for this is, that the Government places the money in the hands of this class of officers and all others who are disbursing officers, that it may remain there until needed for use in the line of that officer's duty; and until that duty requires such payment, or a return of the money to the proper department of the Government, he is in no default, and cannot be required to pay interest."

Here, then, we have a situation analogous to that claimed at bar. If Butterworth-Judson Corporation held these funds as trustee for the Government

and could not use the funds for any other except the purpose of paying for the supplies as the representative of the Government, then it would be utterly inconsistent that interest should be charged. No use of the money was had in those circumstances. This is a reasonable rule, for, a trustee has no opportunity to invest the funds for its own purposes and thereby put it to such use as would justify it in the payment of interest.

The interest situation alone is enough to mark this as a debtor and creditor relation.

Collateral Security.

Article IV of the Supplemental Agreement (R. p. 64) provides for collateral security for the repayment of the balance and is headed "Collateral Security".

> "Article IV. As collateral security for the recoupment or the return of the above mentioned advance, and any interest due, the contractor shall furnish to the Government, on the signing of this agreement:
>
> *a.* The demand note of the contractor for $1,500,000, of even date herewith bearing interest at the rate of 6% per annum and payable to the order of the Secretary of War, on behalf of the United States at his office in Washington, D. C.
>
> *b.* A bond in the sum of $750,000 * * *.
>
> On Failure of the contractor, at any time, to comply with the terms of this agreement, the Government may sell the said demand note at public or private sale, or otherwise, and with or without notice to the contractor, applying the proceeds after payment of the costs of sale toward the repayment of the above mentioned ad-

> vance, and interest due thereon, and accounting to the contractor for the balance, if any. The Government may become the purchaser of said demand note at any such sale, free of all trusts and claims whatsoever.",

The words "return" and "repayment" are used interchangeably in the above mentioned article.

The term "collateral security" is of every-day use. It suggests at once a debtor and creditor relation, and seems inconsistent with a trust. It has been defined as:

> "A concurrent security for another debt whether antecedent or newly created, and is designed to increase the means of the creditor to realize the principal debt which it is given to secure."
>
> *Munn* v. *Macdonald,* 10 Watts (Pa.), 270, 273.

Collateral security, to be of any value, must be of a higher order than the principal obligation. Nothing, obviously, is to be gained to the creditor by taking a junior obligation. The obligation of a trustee to the beneficiary or to the *cestui que trust* is higher than that of a debtor to his creditor. What, then, was to be gained by the taking of a note for $1,500,000 from Butterworth-Judson Corporation if already Butterworth-Judson Corporation was a trustee for the amount of the advance and subject to the high obligations exacted from a trustee? Giving a note as security for this is much the same as though a company gave its stock in securing its own note,—in other words, gave a junior obligation to secure a senior obligation. The answer, obviously, is, that no thought of a trust relation was in the minds of the parties at the time of the giving of the note. The note was simply taken

as collateral for the advance and as evidencing the principal obligation. It is consistent with a debtor and creditor relation and inconsistent with a trust relation.

We hear every day of collateral security for debt. The term is unknown in securing a beneficiary or *cestui que trust* from the misfeasance of a trustee. Trustees are, to be sure, put under bond oftentimes to carry out the purposes of their trust. It is quite another matter when various forms of collateral security are taken to secure the return of a payment made. Such an arrangement negatives the idea of a trust relationship.

Option to Repay.

In the Supplemental Agreement, article III, subdivision *c* (R. p. 63), it is stipulated:

> "The contractor may, at any time, repay to the Government in cash, the entire outstanding balance of said advance with interest due thereon."

This provision further weakens the trust idea. The trustee is not ordinarily considered as a debtor who is to "repay", with interest due thereon, the amount of the trust fund. It is a common enough provision in relationships of debtor and creditor. A brief consideration will show that it is inconsistent with the trust idea. Suppose that Butterworth-Judson were considered as trustee. Who are the beneficiaries? Are they the contractors and others to whom payments were to be made by check, or is the United States the sole beneficiary? The latter cannot be so, for the United States directed the payment of the fund to contractors, and

the like. In the carrying out of the trust, then, the only parties who could obtain money from the trustee are the beneficiaries. The creator of the trust has divested himself of the right to revoke unless reserved. He has dedicated the fund to the beneficiary, whoever that may be, and the beneficiary has the right to sue. If this were not so, the founder of the trust might sue the trustee on the theory that he is suing here,—to recover back the money paid, and the beneficiary of the several contractors and material men could also sue the trustee for moneys due out of the trust fund for building the picric acid plant, etc. Thus the trustee would be exposed to a double liability. All that it amounts to is, that the obligation was a debt obligation. One does not "repay" trust funds, and one does not pay interest on trust funds. Therefore, when it was provided that the contractor might repay the full amount, in cash, with interest due thereon, the trust fund idea immediately disappeared.

As to the law, it would be impossible to add to the careful and cogent reasoning of Judge Mayer, in the Circuit Court of Appeals, in affirming Judge Hand's decision. Nothing beyond referring to that opinion will be attempted, except a brief reference to the many cases in which it has been held that creating a special account in a bank, the funds to be used for a particular purpose, does not create a trust.

The case of *Noyes* v. *First Nt. Bk.*, 180 A. D. (N. Y.) 162, has been followed in its reasoning by Federal courts in several similar cases. It is apposite to the situation here. Therein a special account was opened to meet interest coupons as they came due. The plaintiff was the receiver of a

railroad, and he sued to recover the amount in its special account as the general fund of the railroad company, and Justice Scott, writing for the Appellate Division, held that he was entitled to do so. He says (p. 166):

> "The defendant on the other hand insists that by opening the special accounts and depositing therein only moneys intended to be used for the payment of interest, and instructing, or at least permitting the bank to pay the interest coupons as they were presented, the railroad company created a trust in favor of the holders of outstanding coupons, and that the moneys thus deposited became so impressed with such trust that the bank as such trustee is entitled to retain them and apply them to the purpose for which they were deposited."

The court held that the deposit merely created the relation of debtor and creditor, and that the transaction constituted the bank a depositary for the coupon holders.

The identical rule is found earlier in *Staten Island Cricket Club* v. *Farmers Loan & Trust*, 41 A. D. 321.

In re Interborough Consolidated Corp., 277 Fed. 249. Therein the court held, Judge Mayer writing the opinion, in a case in which interest coupons were concerned (p. 255):

> "It may be, and it will be assumed for the purposes of the argument, that the corporation could so act as to put a fund beyond its control out of which the interest should be paid; but such disposition must be clearly evidenced by acts or transactions which show, in effect, the creation of a trust fund over which the corporation has relinquished control. Nowhere can there be found anything, either in correspondence or in vouchers, which indicates

> that at any time, if the corporation so desired, it could not have withdrawn the deposit from the Empire Co. and deposited the funds elsewhere, or retained them and paid the coupon holders, if it pleased, with currency over its own counter."

Applying this to the case at bar, we find nothing whatsoever in the contracts in question to prevent Butterworth-Judson Corporation from withdrawing the funds it had deposited with the various banks and putting them in other banks. It became the duty of the banks, on receiving authentic checks of Butterworth-Judson Corporation, to pay out the funds on those checks. The banks were not authorized to, and they could not look to the purpose for which those checks were to be used. In other words, the Government did not establish a trust fund at all, but it made an advance payment under certain stipulations as to its application by Butterworth-Judson Corporation.

Can there, in the case at bar, be any doubt that if the various banks had become insolvent, the United States could recover from Butterworth-Judson Corporation either on the main obligation or upon the collateral which was given to secure it?

If the appellants' theory of a trust be adopted the Government could not recover in such case. Had the fund been lost without fault on the part of Butterworth-Judson Corporation, it like any other trustee would be liable only if an improper depository had been selected. Similarly the Surety Companies under the bond for faithful performance would not be responsible because the loss would have occurred without fault on the part of Butterworth-Judson Corporation. It seems absurd that any such result was intended. The purpose

of the whole transaction was to protect the Government and that was best attained by making the Surety Companies guarantors of a debt. A situation has now arisen by reason of the insolvency of Butterworth-Judson Corporation which may result in the Surety Companies being called upon to reimburse the Government; but that is no reason why the nature of the whole transaction should be misconstrued in their interest in order to support a legal theory which would transfer the burden of loss from them to the Banks.

These cases must not be confused with those in which a corporation has set aside funds for the payment of a dividend. In those cases, the control of the fund has left the particular corporation. The courts have held repeatedly that the situation there creates a trust in favor of the stockholders, and that they can sue directly to obtain their dividends. That doctrine has never been applied to the holders of coupons, nor to those standing in a similar position.

The opinion on appeal in *In re Interborough Consolidated Corp.*, 288 Fed. 334, in which case certiorari was denied by the Supreme Court (262 U. S. 752), is to the same effect. That case goes very thoroughly into the rules governing the creation of trusts and equitable liens in bank accounts and will be referred to in the latter connection later on. There again a fund was deposited to meet interest on bonds as they became due. The trust company, the depositary, knew of that fact. The bankrupt was charged with the obligation of payment of the coupons by virtue of a consolidation. The question presented was as to the right of coupon holders to obtain this fund free of the claim of the trustee to have the fund turned over to him.

In those circumstances this court held, Judge Rogers writing the opinion, that the trustee in bankruptcy was entitled to the fund, and that no trust was created therein. Judge Rogers follows the reasoning in the *Noyes* case and comments upon it freely. He says (p. 344) after reviewing the facts:

> "We find it impossible to spell out a trust in favor of the coupon holders, although we admit that we entered upon the consideration of this case inclined to think a trust relationship existed."

In the case at bar the agreement was:

> "The contractor shall deposit the moneys advanced hereunder in special accounts in banks, separate from its other funds and shall draw on said accounts only in payment of expenditures made and obligations incurred in designing * * *."

This is, in its essential facts, the same situation that prevails when money is deposited in a bank for the payment of bondholders' coupons. The facts are not so indicative of a trust as in the *Noyes* case because here there was no agreement on the part of the bank as to how these funds should be paid out. What the bank agreed to do was to pay out on the checks of the depositor. If this is a trust, then who is the beneficiary? Is it the United States, which created the trust, or is it such material men as may thereafter appear?

This point can best be concluded with a portion of the opinion in the last *Interborough* case (p. 345) wherein it is said:

> "The general rule seems to be well established that, where a fund is placed by a debtor

in the hands of a third party with instructions to pay it out on the future orders of the debtor, the fund continues to be the property of the debtor, and the fact that it was set aside for the purpose of paying a specified debt does not constitute it a trust fund."

II.

No equitable lien exists in favor of the United States against the fund.

As already pointed out, the original theory of this action was that the balance of $1,500,000, which was appropriated by the banks, constituted a trust fund. This was the sole theory of the bill. But appellants have departed from that notion and now concede in their brief that the fund was not strictly speaking a trust fund. Indeed, in view of the conclusive reasoning of Judge Mayer, in his opinion in the Circuit Court of Appeals, no other position was open to them. It is, however, their claim now that, although strictly speaking no trust fund existed, an equitable lien was created by reason of the terms of article VI of the Supplemental Agreement, and that Butterworth-Judson Corporation took this fund charged with a lien (*a*) to pay material men, subcontractors, and the like, out of the fund, and (*b*) to return the balance to the United States. They claim further that this equitable lien, so-called, negatives the right of set-off in the bank. The banks all admit that if an equitable lien was in existence at the time of the application of the fund in reduction of the banks' loans to Butterworth-Judson Corporation, then no

right of setoff could prevail if the banks had notice thereof at the time of deposit. The trouble is, so far as appellants are concerned, that no equitable lien ever was created.

The courts and text writers have laid down in clear language the attributes of an equitable lien. Judge Rogers, in the *Interborough* case, *supra*, says (p. 349):

> "A contract whereby a contracting party sufficiently indicates an intention to make some particular property or fund which it describes a security for a debt or other obligations creates an equitable lien on the property so indicated. *Ingersoll* v. *Coram*, 211 U. S. 335."

Pomeroy says, in his work Equity, paragraph 165, regarding equitable liens:

> "It is simply a right of a special nature over the thing, which constitutes a charge or encumbrance upon the thing, so that the very thing itself may be proceeded against in an equitable action, and either sold or sequestered under a judicial decree, and its proceeds in the one case, or its rents and profits in the other, applied upon the demand of the party in whose favor the lien exists."

Judge Hough, in *Beaver Board Cos.* v. *Imbrie* (C. C. A.), 296 Fed. 670, in holding that no lien was created, said (p. 672):

> "Equitable liens demand strict proof of 'intention of parties.' *Westinghouse* v. *Brooklyn, etc. Co.* (C. C. A.) 263 Fed. 532, approving *In re Stiger*, 209 Fed. 148, 126 C. C. A. 96. Indeed, the claim of lien fails for substantially the same reason as does the argument for a trust. *Wadd* v. *Hazelton*, 137 N. Y. 215."

In *Westinghouse Electric & Mfg. Co.* v. *Brooklyn R. T. Co.*, 263 Fed. 532 (C. C. A.), Judge Manton, in his decision, says (p. 536):

> "In order to obtain equitable relief, or to establish an equitable lien, the courts have been strict in demanding that, as a condition of such enforcement, the intention of the parties should be clearly found from the expression of their contractual relation as found in the contract, and it must appear that there is no vagueness or uncertainty as to the terms or substance of the agreement."

As to the attributes of an equitable lien, there are, of course, certain cases in which an agreement to make property specific security for a debt gives the creditor an equitable lien upon the property. The United States Supreme Court has also, in several cases, laid down the rule that in order to constitute an equitable lien, the obligation must be limited to payment out of the fund on which the lien exists. In other words, that a personal obligation cannot be joined with an equitable lien. It appears, too, that an equitable lien is subject to the same rule as a trust fund, *i. e.*, that the intent to create it must be clear and unmistakable.

In *Barnes* v. *Alexander*, 232 U. S. 117, Mr. Justice Holmes said on this point (p. 121):

> "The obligation of Barnes was as definitely limited to payment out of the fund as if the limitation had been stated in words, and therefore creates a lien upon the principle not only of *Wylie* v. *Coxe*, *supra*, but of *Ingersoll* v. *Coram*, 211 U. S. 335, which cites it and later cases."

In *Fourth Nat. Bk.* v. *Yardley,* 165 U. S. 634, much the same principle is found, Mr. Justice White saying:

> "The deduction arises that, as it cannot be reasonably conceived that the loan would have been made without reference to and assignment of the particular fund from which alone the hope of immediate payment was to be reasonably expected, the parties must have and did intend to create a particular appropriation, charge, or lien on the property upon the faith of which they both dealt."

In the case of *Ingersoll* v. *Coram,* 211 U. S. 335, Mr. Justice McKenna says, referring to equitable liens (p. 368):

> "In the latter case (*Wright* v. *Ellison,* 1 Wall 16) it is said that it is indispensable to the lien thus created that there should be a distinct appropriation of the fund by the debtor, and an agreement that the creditor should be paid out of it."

It is the contention of the appellees here that no equitable lien existed for the following reasons:

1. The fund in question was not the source of payment. Neither agreement provides for payment to the United States out of the special accounts.

2. The Supplemental Agreement shows that the fund was not set aside as security for its repayment.

3. The specific use of the word "lien", or any equivalent, is omitted from either agreement.

4. There was no definite fund against which the lien could arise.

5. The holder of the lien, whether United States or the subcontractors, was not identified.

FIRST: Taking these up in order, we find that the first essential, viz., that the fund must be the sole source of the payment, is totally lacking. The fund (*i. e.,* Special Accounts) was not even named as one source of repayment (Art. VI, R. p. 64). There was no agreement to repay the balance in the fund. The obligation here was a personal obligation of Butterworth-Judson Corporation. It existed no matter whether the fund disappeared or not. Not only did Butterworth-Judson Corporation agree to repay the advance (R. p. 63), with interest, but it gave security collateral to that promise in the shape of a note for the full amount of the advance ($1,500,000) and a surety company bond ($750,000) to secure the payment of any balance of the advance. It will not be contended that, had this particular fund been lost by reason of the failure of the banks in which it was deposited, thereby the obligation of Butterworth-Judson Corporation to repay would have disappeared. The obligation was to repay—not to repay out of a particular fund. Almost invariably cases in which an equitable lien has been allowed in the United States courts are those where the fund is held subject to the contingent fee of the person instrumental in creating it.

Such was the situation in *Barnes* v. *Alexander, supra, Ingersoll* v. *Coram, supra,* and *Wylie* v. *Coxe,* 15 Howard, 753. In the latter case Mr.

Justice McLean, speaking of equitable liens, says (p. 755):

> "The evidence proves that the complainant was to receive a contingent fee of five per centum out of the fund awarded, whether money or scrip. This being the contract, it constituted a lien upon the fund, whether it should be money or scrip. The fund was looked to and not the personal responsibility of the owner of the claim."

Again in the *Interborough* case, 288 Fed. 334 (certiorari refused, 262 U. S. 752), Judge Rogers says (p. 349):

> "The doctrine of equitable liens has been liberally extended in modern times to facilitate mercantile transactions. But it has been done to give effect to the intention of the parties to create specific charges and that that intention might be justly and effectually carried out. But the courts are not authorized to find the intention when none existed. In *Hopkinson* v. *Forster*, L. R. 19 Eq. 74, at page 75, the Master of the Rolls observed: 'You can have no charge in equity without an intent to charge.' The intent to charge is not made out in this case. It is not established simply by showing that the fund in controversy was originally deposited with the intention that it would be checked out to pay interest on the coupons but without any agreement with the coupon holders that it would be so used. A particular fund is not 'charged', unless it is bound for the performance of an obligation imposed. A charge is defined in Bouvier's Law Dictionary as 'a lien, incumbrance, or claim which is to be satisfied out of the specific thing or proceeds thereof to which it applies'. * * *
>
> It has been held that even an agreement to pay a debt out of a designated fund does not in itself create a lien upon the fund."

The same is said by Judge Woolley in *Shooters Island Ship Yard Co.* vs. *Standard, etc., Co.* (C. C. A.), 293 Fed. 706 (713).

It will be recalled that in that particular case the fund was deposited for the purpose of paying interest on certain coupons, and for no other purpose, in special account, and that the action was brought by one of the coupon holders after the fund had been taken over by the receiver as a general asset of the Interborough Company. In the instant case the special accounts are not mentioned in the agreements as the source of repayment to United States.

SECOND: Turning to the so-called Supplemental Agreement (R. p. 61) we find on page 64 a separate article, *i. e.*, article IV, which recites:

> "As collateral security for the recoupment or return of the above mentioned advance, and any interest due, the contractor shall furnish * * *."

(*a*) provides for the demand note. (*b*) provides for the bond and the method of selling the note, and this is the security for the repayment of the fund in question.

The very giving of the note of $1,500,000 negatives the idea of an equitable lien. The note, as already pointed out, was merely a debtor and creditor arrangement. It was, therefore, in case the equitable lien theory should be adopted, a junior obligation given to secure a senior obligation, for, of course, an equitable lien would be of a higher order than a general debtor and creditor instrument.

Now had it been the intention to make the fund in question security for its repayment, then it seems reasonable to suppose that this intention would

have been mentioned under the article devoted to collateral security just quoted from, but this was not done. It is not until later on, to-wit, article VI (R. p. 64, fol. 192) that we find the provision containing the stipulation in regard to the deposit in special accounts and the restriction as to the use to which the fund can be put. Nothing is said there as to this being security for repayment nor is there any provision whatsoever that the payment back to the Government shall be out of this special account.

The inquiry will arise as to why provision was made for deposit in a special account, separate and apart from the general accounts of Butterworth-Judson Corporation. The reason is not far to seek. Butterworth-Judson Corporation had agreed to account to the United States for this advance by deliveries of picric acid, etc., article III (R. p. 62). It was advisable, for bookkeeping purposes, that this fund be kept separate. There was the further purpose. Speed was a necessary attribute if the picric acid plant was to be availed of. It was the desire of the Government that these funds, advanced for the purpose of paying for picric acid, should be used in the development of the plant and in producing that chemical rather than for the general uses of the corporation. The agreement so to use the fund, however, did not create a lien upon the fund. It was simply an agreement existing between the United States and Butterworth-Judson Corporation as to the general purposes for which the checks should be drawn.

THIRD: It is noteworthy that there is no language in the Original or Supplemental Agreement containing the word "lien", or any equivalent phrase so far as this particular fund is concerned. What

could have been simpler in article VI of the Supplementary Agreement (R. p. 64) than to say that a lien exists on this fund for the purpose of its repayment? It is as significant that this is omitted as it is that the use of the word "trust" in relation to that fund, is specifically omitted.

FOURTH: There was lacking a definite fund against which the lien could operate. The fund here in question consisted, first, of $1,500,000, the amount of the advance or any balance left unexpended from that, and second, if the contracting officer so required, funds paid by the Government to the contractor, reimbursing the contractor for expenditures made from this advance in designing, constructing and equipping the plant, as provided in the main agreement. In other words, the fund constantly changed. It consisted of the balance of the advance, and it also could consist of further funds belonging to the contractor, Butterworth-Judson Corporation, received by it by way of payment from the Government. Certainly it could not be said that it was the intention of Butterworth-Judson Corporation to create a lien upon this entire sum, consisting, very largely, of money to which it had a clear title.

FIFTH: The identity of the owner of the supposed lien is in doubt. The United States claims to be the owner of the lien but only to the extent of any balance unexpended. The lien owners then, up to the time of the cessation of the work under the contract, were the various material men, laborers, and the like, who were entitled to payment for their supplies. Here, again, the source of payment was not limited to this fund. The material men and subcontractors could collect from Butter-

wo:th-Judson Corporation, no matter whether the fund was dissipated or not. Their security was not the fund in question and was not limited to it. It will be seen, then, that both the amount of the lien and the holders of the supposed lien, must have changed constantly if any lien were created, and this, in itself, is fatal to the theory of an equitable lien.

The fact that this article VI creates a special account, has no bearing on the subject. Special accounts are subject to setoff continuously. It was so held in the *Interborough* case and in the *Continental & Commercial Traction Co.* v. *Chicago* case, 229 U. S. 435, and numerous other cases already referred to. Clearly the deposit falls under that class which Judge Rogers mentions in the *Interborough* case, where he says (p. 347):

> "If a fund is deposited in a bank for a specific purpose, but subject to the depositor's check, it remains the property of the depositor, and is subject to the right of set-off."

The same principle is found in *Cushing* v. *Chapman*, 115 Fed. 237 (239).

The fact that an account is designated as "special account" does not mark it as a trust fund nor subject it to an equitable lien.

> *Whiting* v. *Hudson Tr. Co.*, 234 N. Y. 394 (402).

It appears, then, that the contracts in suit from which the equitable lien must arise, if it exists fall very far short of that requirement already referred to, that in order:

> "to establish an equitable lien * * * the intention of the parties should be clearly found from the expression of their contractual relation as found in the contract."

And further, that:

> "it must appear that there is no vagueness or uncertainty as to the terms or substance of the agreement."

Finally the principles laid down by Judge Woolley in *Shooters Island Co.* vs. *Standard Shipbuilding Corp.* (C. C. A., 3rd Circuit), 293 Fed. 706 (713), are exactly applicable to the situation at bar.

There the United States Shipping Board Emergency Fleet Corporation claimed an equitable lien on certain property which had been acquired with money loaned by the Fleet Corporation. In holding that there was no lien in favor of the Fleet Corporation, Woolley, *J.*, said at page 712:

> "The question of an equitable lien in favor of the Fleet Corporation based on its advance of the purchase price, is, therefore, narrowed to the question whether the mere advance or loan of money for the purpose named creates an equitable lien which displaces the prior legal lien of the mortgage held by the Shooters Island Company. * * * The claimed equitable lien, therefore, rests on the single fact that money which the Fleet Corporation loaned or advanced to the Shipbuilding Corporation under shipping contracts was used in the purchase and improvement of the land. That the Fleet Corporation intended it to be so used is evidenced by the warrant issued for the money and its expenditure, just as other moneys amounting to more than $5,000,000 were advanced and authorized to be expended in enlarging and improving many parts of the shipbuilding plant erected on the several tracts of land in the states of New York and New Jersey. No security was asked, and, so far as the record shows, no agreement was made for re-

payment of these funds. They were advanced on account of ship construction, and to facilitate and expedite that construction they were authorized to be expended upon the plant as well as upon the ships themselves. Unless we are to hold that such expenditures, singly and alone, create in each instance, wherever applied and expended, an equitable lien in favor of the party advancing the money, thereby divesting rights held under an existing mortgage, we are constrained to hold that the purchase of lands from the State of New Jersey and the building of ways thereon with moneys which the Fleet Corporation either loaned or advanced to the Shipbuilding Corporation do not, without more, give it an equitable lien on the properties so purchased and improved. We freely admit that under different circumstances an equitable lien could have been created which would have displaced the lien of the prior mortgage under its after-acquired property clause. But under the circumstances as they were, we are unable to find, either on authority or principle, that the rights of one silently and unconditionally loaning money for the purchase and improvement of property are superior to the rights of a party who holds the lien of a prior mortgage against the property. That the money was loaned under the compulsion of an urgent national necessity may justify what was done but does not disturb vested rights."

III.

A complete right of set-off accrued to the banks on making the loans.

This right of set-off of deposits against loans is referred to in appellant's brief as being an "extraordinary" right (Appellant's Brief, p. 27). This is a strange notion. There is nothing novel about such set-offs. To describe them as bankers' liens is a misnomer. It has been held in a great number of cases that the deposit of money with a bank, whether in general or special account, makes the bank a debtor of the depositor to that extent,

> *Marine Bk.* v. *Fulton Bk.*, 2 Wall. 252;
> *Burton* v. *U. S.*, 196 U. S. 283, 301,

and from this debtor and creditor arrangement the right to set off a balance on a deposit against the customer's indebtedness must inevitably arise.

> *New York County Nat. Bk.* v. *Massey*, 192 U. S. 138;
> *Studley* v. *Boyleston Bk.*, 229 U. S. 523, 527.

There is nothing peculiar about this. The same situation arises between every debtor and creditor. No case can be imagined where A, owing money to B, and having a debt against B, both matured, cannot set off his debt against B's claim.

In the instant case, as was pointed out in the statement of facts, the banks had loaned to Butterworth-Judson Corporation $1,250,000, these loans all being due and unpaid. And on April 21, 1922, the balances in these special accounts amounted to $519,631.99. On that day the banks were entitled to

off-set this amount against their indebtedness, and the pleadings show that they did so, and that their indebedness from Butterworth-Judson Corporation was thereby reduced to an aggregate of $730,368.01 still unpaid.

A case of first importance is *Continental & Commercial Tr., etc.*, v. *Chicago, etc.*, 229 U. S. 435. The facts, so far as germane to the situation here, are summarized by Mr. Justice Day (p. 441). He writes:

> "The facts with respect to the bank balance of $575.79 are: On February 10, 1905, the Bank called the loans of Prince, and, such loans not being paid, the Bank applied to them the sum of $3,095 then on deposit in Prince's checking account, leaving the sum of $3.25 in that account. On the same day the Bank agreed with Prince that, if he would thereafter make deposits for such purpose, it would pay certain salary and payroll checks of Prince and checks issued to the Board of Trade Clearing House. Checks were paid on divers days between the fourth and fourteenth of February, 1905, to the amount of $2,506.46, and Prince deposited with the Bank between the tenth and fourteenth of February a total of $3,079, all such items being entered upon the books of the Bank as of February 14, 1905. The amount deposited exceeded the amount checked out by $572.54, and this amount, with the $3.25 remaining to the credit of Prince, as above set forth, left a balance of $575.79, which the Bank on February 14 applied to Prince's general indebtedness to it."

It was this $575.79 which the trustee was endeavoring to recover. This relief was denied it, Mr. Justice Day saying (p. 446):

> "As to the $575.79, we think the right to set off this deposit is established by the principles

laid down in *New York County National Bank* v. *Massey, supra.* Here there was a deposit subject to be checked out by the bankrupt for specific purposes. The money was not placed in the bank with a view to giving it a benefit, except indirectly, because of the deposit. It was subject to Prince's check, and all of it might have been checked out for the purposes intended."

It is strenuously contended by the appellants here that, in making this application of their deposits, the banks violated a principle of law laid down in various cases, to the effect that where the bank has agreed to use the money, in the account, for certain definite purposes, it could not apply to them the right of set-off. Appellant has cited a long list of cases in behalf of this doctrine. The distinction is, that in no one of them was there a general right of the depositor to check against the account for such purpose as he saw fit. No one will deny the principle that if funds are deposited with a bank to meet a particular check and the banker, on accepting the deposit, knows of this purpose and accepts the deposit with knowledge of it, that he thereby precludes himself from off-setting the deposit against any loans due the bank from the depositor. That is what is meant by the words (3 R. C. L. p. 588).

> "provided there is no express agreement to the contrary and the deposit is not specifically applicable to some other particular purpose."

Such are the cases of:

Wilson v. *Dawson,* 52 Ind. 513;
Straus v. *Tradesmen's Nat. Bk.*, 36 Hun, 451;
Fitzgerald v. *State Bk.*, 64 Minn. 469;
Carter v. *Martin,* 22 Ind. App. 445;

Woodhouse v. *Crandall,* 197 Ill. 104;
Lyman v. *Belfast Nat. Bk.,* 98 Me. 448;
First Nat. Bk v. *Barger,* 150 S. W. 726;
Smith v. *Sanborn State Bk.,* 147 Ia. 640;
Dolph v. *Cross,* 153 Ia. 289;
Turkington v. *1st Nat. Bk.,* 96 Conn. 302 303);
Continental Nat. Bk. v. *Moore,* 299 Fed. 270.

All of these cases are set forth in appellant's brief as negativing the right to a set-off on the part of the banks. In each instance the bank was notified, and either expressly or impliedly agreed that the deposits in suit should meet certain specific obligations which were certain both as to the amount and the name of the person to whom the payments should be made.

Of course, after making an agreement of that kind at the time of taking the deposit, the bank could not be allowed to violate it and use the money for some other purpose.

But in the case at bar, the bank took the deposits in question when the persons to whom the money should be paid, and the amount of the payments, were entirely unknown, and at a time when there was nothing owing from the depositor to the banks, all the loans having been made after the deposits had been made. The fact that the banks knew that the depositor was opening a special account and that it had agreed with the United States, which was making a payment for picric acid, that it would check out the funds for a certain purpose, does not militate against this right of set-off.

Why not?

IV.

As to the opinion of the Circuit Court of Appeals and the general equities.

There is attached as a supplement to the opinion of the Circuit Court of Appeals a copy of the order of the Secretary of War, dated April 22, 1918, creating the War Credits Board. It was under the provisions of this order that the contract in suit was made (R. p. 319 *et seq.*). In that portion of the opinion Judge Mayer says:

> "We think we may notice this order by way of argument for it is an interesting evidence that the practical construction of the statute by the Secretary of War is in harmony with our construction."

Attention is then called (R. p. 320) to the two provisions regarding (1) security, and (2) terms. Under the former, after providing for security by way of (*a*) guaranties, notes, bonds and the like, (*b*) stocks, etc., (*c*) mortgages, (*d*) other equivalent security, (*e*) refers to the Government as a preferred creditor in bankruptcy, and (*f*) refers to those cases in which the funds are definitely to be held in trust. It is there said:

> "Similar considerations govern advances made under such conditions and restrictions that the funds advanced are definitely procured to be held in trust until paid out under the contract, for property to which the Government holds or automatically acquires title, or in meeting expenses incurred in the direct performance of the contract for supplies."

As Judge Mayer points out (R. p. 320):

> "In respect of subdivision (*f*) under the heading 'Security.' it is apparent that, under some

> circumstances, it was desired that the funds advanced were to be definitely procured to be held in trust until paid out under the contract. The theory of this provision necessarily was that the funds should be advanced and that arrangements should be made with the contractor by which these funds should be placed in trust and, obviously, the trustee was not to be and could not be either the United States or the contractor. The provision was solely by way of security and apparently contemplated that the funds should be placed in the hands of some third party under a definite trusteeship and plainly the very purpose of such a trusteeship as security was inconsistent with any right, such as that in the case at bar, on the part of the contractor to draw against the funds advanced by the United States. Under this subdivision (*f*) ordinarily the fund would be held in trust to be paid out by the trustee, *i e.*, the third party, against appropriate vouchers or in accordance with some similar procedure."

What this amounts to is, that under the order in question two forms of security for advance were contemplated. The first form is covered, in general, by the provisions of (*a*), (*b*) and (*c*), and contemplate advances in which the title to the fund passes to the contractor and repayment is to be secured by one of the several methods enumerated. The second is comprehended under articles (*d*), (*e*) and (*f*) (R. p. 321), and governs those occasions on which "other equivalent security" is to be taken, (*e*) being an agreement not to encumber property and (*f*) referring to conditions, etc. that "the funds" are "held in trust". The advance in question in this cause, of course, comes under the former subdivision. It was secured by (*a*) the giving of a note for $1,500,000, bearing interest and signed

by Butterworth-Judson Corporation, (*b*) by a bond of $750,000 to secure the return of any balance of the fund. The condition of the bond was (R. p. 75):

> "* * * if the Principal shall fully perform all of the obligations and agreements to be by it performed under the said supplemental contract * * * and shall return to the United States * * * the full amount of the said advance payment of $1,500,000, with interest as prescribed therein, then this obligation shall be void * * *."

It is evident, then, that the bond was given to secure the repayment of the balance of the fund. In other words, it and the note for $1,500,000 were the security mentioned under subdivision (*b*) of the section entitled "Security" in the order from the Secretary of War.

The reasoning of Judge Mayer, in referring to paragraph (*f*) that in those cases where a trust should be set up the trustee must be other than the United States or the contractor, is fully in accord with the court's opinion in *Brown* v. *Spohr*, 87 A. D. (N. Y.) 522, (529), where the court wrote:

> "There are four essential elements of a valid trust of personal property: (1) a designated beneficiary; (2) designated trustee, who must not be the beneficiary; (3) a fund or other property sufficiently designated, * * * to enable title thereto to pass to the trustee, and (4) the actual delivery of the fund or other property or of a legal assignment thereto to the trustee with the intention of passing legal title thereto to him as trustee."

The appellant seeks to make of this paragraph (*f*) an argument in favor of the existence of a

trust on the fund in question (Appellant's Brief, p. 23). It states one of the directions to the Government's contracting officer was that the advance payment should be made:

> "under such conditions and restrictions that the funds advanced are definitely procured to be held in trust * * *"

quoting only that portion of (*f*) as would make the reading what it seeks. Of course, the order provides nothing of the kind.

Leaving out the opening sentence of the paragraph quoted and substituting for it the words which the appellants use, viz, a direct command that the funds shall be so advanced, is to change and frustrate the plain meaning of the paragraph.

In considering the general equities of the situation existing here, as revealed by the pleadings, certain matters should not be overlooked. In the first place, it appears by the pleading that the appellant was guilty of laches in its demand for the balance in the account. The chronology of the situation will demonstrate this. The deposits in the several accounts were made in May, 1918. On December 6, 1918 (R. p. 27) the agreement with Butterworth-Judson Corporation was canceled by the Government and further expenditures from the fund ceased. Instead of promptly notifying Butterworth-Judson Corporation and the banks that it claimed this fund as a trust fund, or claimed an equitable lien thereon, the Government did nothing whatsoever until long after the appointment of a receiver, which took place April 22, 1922. The first demand was by the bringing of the suit, January 9, 1923 (R. p. 2). It appears then that over four years elapsed between the time that expenditures ceased when the right of the

Government to the fund, if any, became fixed, and at the time of demand.

Meantime, these particular appellees had changed their position, relying upon the deposits in question, for we find that the loans, as set forth on page 3 of this brief, were all made between July 21, 1919, and March 28, 1921, so far as relates to the Chase National Bank, New York Trust Company and American Exchange National Bank. Had the Government moved promptly to sequester these funds, or to impress a lien upon them, had any existed, these loans would not have been made. It is one of the clear principles of equity that:

> "Equity aids the vigilant, not him who sleeps upon his rights."

The government, by delaying to move, permitted these appellees to advance vast sums of money to Butterworth-Judson Corporation. It will not now be heard to say that it moved promptly, or is entitled to recover.

Another matter as bearing on the general equities of the situation, should be considered. Concededly, the only balance which the Government has due from Butterworth-Judson Corporation is $611,450 (Appellant's Brief, p. 14). Out of the balance of $1,500,000, legitimate expenditures had been made so that the amount of these balances was reduced to $519,631.99. But the condition of the United States, and through it of the surety companies who are the real parties in interest on this appeal, is vastly improved by the fact that the banks regarded these deposits as being such as were subject to set-off, for although the utmost that the surety companies can receive from the bank is, concededly,

$519,631.99, yet the banks, by loaning $1,250.000 to Butterworth-Judson Corporation on the strength of the deposits, have, it must be presumed, to that extent vastly increased the opportunity of the United States and the surety companies to recover on their preferred claim out of the assets of Butterworth-Judson Corporation. The estate of Butterworth-Judson is richer by $1,250,000 than as though the banks had not made their loans. In other words, the surety companies are benefiting by these loans by an enrichment of the estate to the net amount of $730,368.01, even though the right of the banks to the set-off in question be upheld. A complete estoppel thus arises.

As shown, the surety companies are the sole parties in interest. They are corporations for profit. No equities are peculiar to them.

Musco v. *United Surety Co.*, 196 N. Y. 459 (465).

Conclusion.

It seems clear that the pleadings are insufficient to constitute a cause of action in equity, for (*a*) there was no trust relation existing between the United States and Butterworth-Judson Corporation covering the deposits in the special accounts, (*b*) there was no equitable lien in favor of the United States upon the account in question, (*c*) the right of set-off of the deposits in question, as a partial recoupment to the banks for the sums loaned after the deposits were made, is fully established, (*d*) the equities are all in favor of the defendant banks.

It, therefore, follows that the decree of the District Court dismissing the bill as to the banks, as affirmed by the Circuit Court of Appeals, should be affirmed.

Respectfully submitted,

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UNITED STATES ET AL. *v.* BUTTERWORTH-JUDSON CORPORATION ET AL.

APPEAL FROM THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 338. Argued December 9, 10, 1924.—Decided March 2, 1925.

1. Under the Act of October 6, 1917, § 5, c. 79, 40 Stat. 383, the Secretary of War was authorized to advance money to a contractor for carrying out a contract for producing and furnishing supplies of picric acid to the War Department and could provide the "adequate security" called for by the act by requiring the balances of the advanced funds be kept in special deposits subject to a lien in favor of the Government, in addition to requiring a collateral note of the contractor and surety bond. P. 392.
2. Under a contract for the erection of a plant, and manufacture and delivery to the Government of picric acid, the Government advanced the contractor moneys, to be deposited at interest in special bank accounts separate from the contractor's other funds, such money to be drawn on only for specified purposes, and the balance thereof to be accounted for to the Government, either by deliveries of the acid at a specified price or by return of the amount, less authorized deductions, *Held*, (assuming that the title passed, establishing the relation of debtor and creditor,) that the purpose and effect of the special accounts were to provide security for the United States and that an equitable lien upon them existed in its favor, although not expressly reserved in the agreement. P. 393.
3. An equitable lien reserved by the United States as security for the proper use or return of funds advanced to a contractor, which under the agreement were deposited in special bank accounts for the purpose of providing such security,—*held* superior to the right of the banks (they having notice of the agreement,) to set off such deposits against debts owed them by the contractor. P. 394.

297 Fed. 971, reversed.

APPEAL from a decree of the Circuit Court of Appeals affirming a decree of the District Court which dismissed, as to defendant banks, a suit brought by the United

States against the Butterworth-Judson Corporation and its receivers, the banks and several surety companies. The bill sought an accounting under a contract between the first named defendant and the United States, and to apply the balances of special deposits made by the contractor with the banks to the amount found due under the contract—also a decree for any deficiency against the surety companies on bonds furnished by the contractor. The contractor, receivers and surety companies answered and also filed counter claims against the banks, seeking to have the special account deposits paid over to the United States. The banks' motions to dismiss the bill and counter claims were sustained by the courts below.

Mr. William Marshall Bullitt, with whom *Mr. Solicitor General Beck* and *Mr. Victor House,* Special Assistant to the Attorney General, were on the brief, for the appellants.

Mr. William C. Breed, with whom *Mr. Edward J. Redington* was on the brief, for National Newark & Essex Banking Company of Newark, N. J.

Mr. David Paine, with whom *Mr. Michael H. Cardozo, Jr.,* was on the brief, for Chase National Bank, et al.

MR. JUSTICE BUTLER delivered the opinion of the Court.

The United States, plaintiff below, and certain surety companies, defendants below, appeal from a decree of the Circuit Court of Appeals, 297 Fed. 971, affirming that of the District Court dismissing the complaint as to certain banks, defendants below, and dismissing counterclaims set up against the banks in the answers of the surety companies. The decree also dismissed counterclaims against the banks, set up in the answer of the

Butterworth-Judson Corporation and its receivers, defendants below. They have not appealed.

The controversy concerns the right of the banks, as against appellants, to set off against debts owing to them by the Butterworth-Judson Corporation the deposit balances remaining with them in special accounts.

The Butterworth-Judson Corporation, a contractor, and the United States made an agreement, dated May 9, 1918. The contractor agreed to select a site and, for a profit of one dollar and no more, to design, construct and equip thereon a plant for the production of picric acid, and to manufacture for the United States 72,000,000 pounds for 53 cents per pound. The entire cost of the plant was to be paid by the United States. The contractor was to make all necessary expenditures for the construction work, and the United States from time to time was to reimburse it therefor. The United States agreed to recommend to the War Credits Broad an advance payment to the contractor of $1,500,000, upon such terms as the board might prescribe; and also agreed that, if the board should require interest on the advance payment, it would reimburse the contractor as a part of the cost and expense of the latter under the contract. The United States reserved the right to cancel the agreement at any time that its need for the plant or output ceased. It agreed in such event to reimburse the contractor for its expenditures, to assume all its outstanding obligations incurred under the contract, and to pay for all the picric acid wholly or partly manufactured; and it agreed, in case of cancelation before 18,000,000 pounds were delivered, to pay three cents per pound for the undelivered portion up to that amount.

The same parties made a supplementary agreement, dated May 22, 1918. The United States agreed to advance $1,500,000 to the contractor. The contractor agreed to account for the advance with interest, by applying that

amount to the payment of vouchers covering deliveries of picric acid. The contractor reserved the right at any time to repay in cash. If the United States did not recoup, through the deliveries of picric acid, the total amount of the advance with interest, the contractor was required to "return to the Government, on demand, any balance of the said advance and interest after deducting the total of any recoupments made as hereinabove provided, together with all liquidated accounts that may be due and owing under the Principal Agreement from the Government to the contractor." The contractor agreed to give the United States, as collateral security for the recoupment or return of the above mentioned advance and any interest due, its demand note for $1,500,000, bearing six per cent. interest, and to furnish a bond in the sum of $750,000, with surety, for the performance of the agreement. The United States reserved the right, in case of failure of the contractor to comply with the agreement, to sell the note and apply the proceeds to the repayment of the advance, accounting to the contractor for the surplus, if any. But it agreed not to negotiate or demand payment of the note, so long as the contractor was not in default, and to return the note and bond upon complete performance. And the agreement contained the following: "The contractor shall deposit the money advanced hereunder in special accounts in banks, separate from its other funds, and shall draw on said accounts only in payment of expenditures made and obligations incurred in designing, constructing and equipping the plant specified in the Principal Agreement, and for other equipment and for material, labor and overhead expense, required in the direct performance of the Principal Agreement, unless otherwise authorized in writing by the War Credits Board." It was stipulated that the contracting officer might require the contractor to deposit in the special accounts the funds paid by the Government, reimbursing

the contractor for expenditures made from such advance payment. The contractor was to collect from the banks with which such accounts were kept such interest as is usually allowed for similar accounts, and credit or pay that interest to the Government.

The bonds provided for in the principal and supplementary agreements were furnished. The United States advanced $1,500,000 to the contractor, and the latter gave its note as agreed. The contractor deposited the money with defendant banks in special accounts, and entered upon the performance of the agreement. It made withdrawals from these accounts for the specified purposes, and from time to time deposited therein the sums paid to it by the United States in reimbursement of its expenditures. The banks at all times knew that the moneys deposited by the contractor in the special accounts consisted exclusively of the advance payment and replenishments, and that all deposits and balances in these accounts were held pursuant to the principal and supplementary agreements. Shortly after the Armistice, the plant being less than half completed, the United States terminated the principal agreement. No picric acid had been manufactured. The United States reimbursed the contractor and assumed all the latter's obligations under the principal agreement. It was shown in a creditors' suit in the District Court that the contractor was unable to pay its debts, and April 22, 1922, the court appointed receivers who are defendants in this case. Neither the contractor nor its receivers accounted to the United States for any part of the advance of $1,500,000 or interest, except $348,550, leaving unaccounted for, as the United States claims, $1,151,450. The total of the balances in the special accounts on April 22, 1922, was $519,631.99. On that day, the contractor was indebted to each of the banks in an amount in excess of the balance in the special account with it, and each bank set off the amount of such deposit against the debt owed by the contractor.

The suit was for an accounting and to have the balances in the special accounts applied on the amount found unaccounted for and due the United States on the settlement of the account between it and the contractor. In affirming the District Court, the Circuit Court of Appeals held that the advance payment was for supplies purchased and thereafter to be delivered, and that the Secretary of War had no authority to retain title to the moneys advanced and make the contractor agent of the United States for its disbursement; that the supplementary agreement created no relation of trust or agency between the parties, but only that of debtor and creditor. It held that the doctrine of trust, or equitable lien, or equitable assignment, did not apply, and that the banks had the right of set-off. The appellants maintain that the United States had an equitable lien on the balances in the special accounts, and that the banks, having notice of the lien, could not set off the deposits against the debts owed them by the contractor.

The advance payment was made under the authority of an act of Congress of October 6, 1917, § 5, c. 79, 40 Stat. 383, which provides: "That the Secretary of War and the Secretary of the Navy are authorized, during the period of the existing emergency, from appropriations available therefor to advance payments to contractors for supplies for their respective departments in amounts not exceeding thirty per centum of the contract price of such supplies: *Provided,* That such advances shall be made upon such terms as the Secretary of War and the Secretary of the Navy, respectively, shall prescribe and they shall require adequate security for the protection of the Government for the payments so made." The act was intended to relax, during the period of the war, the strict rule against advances of public money. See R. S. § 3648. *The Floyd Acceptances,* 7 Wall. 666. The act plainly authorized advance payments, such as that covered by

the supplementary agreement. It left the terms to the discretion of the Secretary of War, subject to the duty to require adequate security, but the act did not specify or limit the amount or kinds of security to be taken. A lien upon and right over the balances in the special accounts required to be kept is clearly within the meaning of the word "security," as used in the act. The power of the Secretary to exact such a lien or right in addition to the collateral note and surety bond cannot be doubted.

The agreements made the balances in the special accounts security for the obligations of the contractor and so created an equitable lien in favor of the United States.

The established rule as to the creation of equitable liens is stated in *Walker* v. *Brown*, 165 U. S. 654, 664: "The doctrine may be stated in its most general form that every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, or fund, therein described or identified, a security for a debt or other obligation, or whereby the party promises to convey or assign or transfer the property as security, creates an equitable lien upon the property so indicated, which is enforceable against the property in the hands not only of the original contractor, but of his heirs, administrators, executors, voluntary assignees and purchasers or encumbrancers with notice." See also *Hauselt* v. *Harrison*, 105 U. S. 401, 405; *Ingersoll* v. *Coram*, 211 U. S. 335, 368; Pomeroy's Equity Jurisprudence (4th ed.) §§ 1233, 1234, 1235. It may be assumed that the United States did not retain title to the advance payment, and that when it was made it became the property of the contractor, and also that the contract contemplated that the relation of debtor and creditor might arise. The contractor's obligation, subject to its right at any time to repay the Government in cash,

was to account for the amount of the advance with interest, by deliveries of the picric acid at the agreed price, or to return that amount to the United States, after making the authorized deductions, if any. The contractor's note and the surety bond were given to secure performance of the agreement. And the requirement that the contractor deposit the money in special accounts in banks, separate from its other funds, and collect and account for interest on deposit balances, and draw on such accounts only for the purposes specified and return the balance of the advances, was additional security. It was to make more certain the performance of the agreement. The purpose and effect of the special accounts was to identify and keep separate the advance payment and replenishments, to limit the use of the fund to the purposes specified, and so to make it available as security to the United States. Failure of the agreement expressly to grant a lien on or declare these balances to be additional security is not significant. See *Barnes* v. *Alexander,* 232 U. S. 117, 121. The Armistice came, and the United States terminated the agreement before there was any production at the plant. The advance and replenishments were not wholly expended, or accounted for by deliveries of picric acid. The contractor was bound to "return" and the United States was entitled to demand and have "any balance of the said advance" remaining after the deductions authorized. The agreements show that the parties contemplated that the need for picric acid might cease before the advance payment was covered by deliveries; and bound the contractor, in that event, to return the balances in the special accounts to the United States. This case is plainly within the rule.

Ordinarily, the relation existing between banks and their depositors is that of debtor and creditor, out of which the right of set-off arises. As a general rule, in the

absence of an agreement to the contrary, a deposit, not made specifically applicable to some other purpose, may be applied by the bank in payment of the indebtedness of the depositor. See *Studley* v. *Boylston Bank*, 229, U. S. 523, 528; *New York County Bank* v. *Massey*, 192 U. S. 138, 145; *National Mahawie Bank* v. *Peck*, 127 Mass. 298, 300. But a bank having notice that a deposit is held by one for the use of or as security for another has only such right of set-off as is not inconsistent with the rights of the latter. Here, the banks had knowledge of the agreements, under which these balances constituted security for the advance made by the United States. By acceptance of the moneys furnished in accordance with the agreement, their right of set-off was made subject to the rights of the United States and the obligations of the contractor. See *National Bank* v. *Insurance Co.*, 104 U. S. 54, 71; *Union Stock Yards Bank* v. *Gillespie*, 137 U. S. 411, 421; *Boyle* v. *Northwestern National Bank*, 125 Wis. 498, 507. The appropriation of these balances by the banks cannot be sustained.

Decree reversed.